HOW BUSH MANAGES • POLAND'S GAMBLE • WHERE TO INVEST NOW

AUGUST 27, 1990 NO. 18

FORTUNE

INTERNATIONAL

THE 25 YEAR-OLDS

Today's young managers are nothing like yuppies

Intel's Aaron Evans, 25, and friend Meredith Mendelsohn

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Austria	S 50	New Zealand	NZ $7
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Denmark	Kr 35	Pakistan	Rs 55
France	F 25	Philippines	P 84
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AUGUST 27, 1990

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INTERNATIONAL

"The older managers think that if the shoe doesn't fit, you should wear it and walk funny. The baby-busters say to throw it out and get a new shoe." PAGE 24

"Once you stop growing, you start dying." PAGE 32

"Loyalty is not a character flaw." PAGE 38

"Defense contractors that aren't marketing oriented are going to find themselves on the outside looking in." PAGE 48

"He'll plant 50-foot palm trees. The rest of us buy 20-foot palms and hope they'll grow." PAGE 60

"Right now, I know more about drinking Pepsi than I do about running it. But that will change fast." PAGE 65

"The S&L debacle may be only a prelude to a far larger crisis in American financial institutions." PAGE 67

ABOVE: Tim Connell, a Georgia-Pacific manager, with his wife, Lisa. Photograph by Alen MacWeeney.

COVER: MacWeeney also took this shot of Evans, a microelectronics salesman, and Mendelsohn.

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No one else in North America controls a single property of such vast size and potential: 100 square miles of mostly raw land sitting squarely in the path of Los Angeles' southward sprawl. Worth $2 billion now, Donald Bren promises to keep his wealth climbing with his "build and hold" strategy. *by Gary Hector*

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EDITOR'S DESK

JAKE WYMAN

Cover story author Alan Deutschman (top left) and FORTUNE staffers who are 25 or less

HENRY LUCE was only 24 and Britton Hadden barely 25 when those two daring Yale grads first published *Time*—and launched our parent company in 1923. So we at FORTUNE have a special respect for what people can accomplish at that early age. Just consider the many companies started by visionaries 25 and under: Apple Computer, R.J. Reynolds, Sears Roebuck, Grey Advertising, Microsoft, Hallmark—and more.

Right now, the 25-year-olds are the cutting edge of a new generation: the baby-busters. And as our reporter Alan Deutschman, himself 25, discovered after weeks of interviewing them, they are "profoundly different" from the yuppies of the baby boom. No longer is careerism king: Independence and self-fulfillment have replaced that Eighties obsession. As smart young workers become one of our scarcest resources, today's executives would be wise to understand them. Step one: See our cover story on page 24.

Also in this issue, our prolific associate editor Gary Hector corrals two of America's most successful business leaders. First he tells how a tough Marine from North Carolina named Hugh McColl lassoed the largest bank in Texas and is building a herd to rival the national big boys. Then, in the real estate arena, Hector profiles billionaire developer Donald Bren, who is reshaping a large part of Southern California. Although McColl and Bren are both hard to pin down for interviews, Hector got them. He started talking with Bren last year and even followed him over a six-foot chain-link fence to get the scoop. For an inside perspective on folks who will mold tomorrow's world of business, read on.

KIM KOMENICH

Writer Gary Hector

Marshall Loeb

MANAGING EDITOR

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In banking today, it's important to see the whole as clearly as the parts.

Should you borrow in the Euromarkets or issue debt here at home?

What about investing your corporate cash? Go long, short, fixed, floating?

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Last year, a major U.S. consumer advocate publication conducted a survey comparing 14 brands of microwave ovens. The results: When a grandmother from Pittsburgh bought a Samsung, she bought the most reliable microwave oven made.

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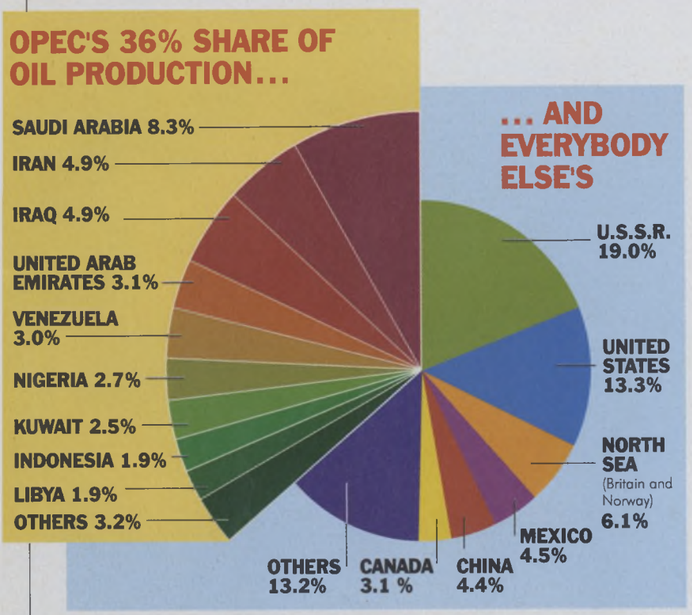


OPEC has extra muscle because other producers don't export as much oil.

THE PROSPECTS FOR OIL NOW

■ Iraq's blitzkrieg on the Arabian Peninsula rudely reminds us that, even after the Cold War has ended, we live in a dangerous world. And the remarkable vision of the U.S. and the Soviet Union quickly joining to condemn an aggressor tells us something more: The global confrontations of the 1990s will not be between East and West, but between North and South, pitting the affluent industrial nations against the increasingly insistent—and well-armed—countries of the Third World. At bottom, Iraq's grab of Kuwait is aimed at squeezing more billions out of the industrial nations that depend on OPEC oil.

The lessons of this episode are familiar but still important:

■ The U.S. and its allies should be taking every sensible step now to conserve oil and develop new sources. For example, it makes more sense than ever to open the Alaska National Wildlife Refuge for exploration. It may well be America's last big puddle of oil.

■ Developing domestic nuclear power is less dangerous than depending on foreign oil.

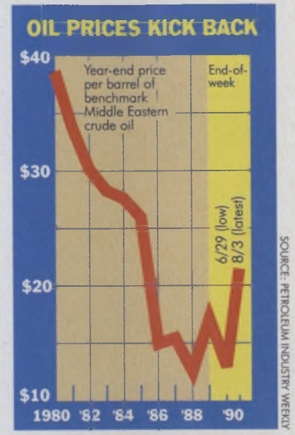
The invasion ordered by Iraq's dictator, Saddam Hussein, could turn out to be one of history's most profitable military assaults. Unless some power topples the swaggering bully, Kuwait will probably have to forget the $10 billion to $20 billion it lent Iraq to help fund its eight-year war against Iran. Hussein may have an even bigger target in his sights: Saudi Arabia, or more specifically, Saudi oil policy. Through most of the 1980s, spare oil production capacity in OPEC led to world oversupply and weak crude prices (see chart). But rising global demand is using up OPEC's excess capacity. Only Saudi Arabia, which once produced ten million barrels a day but now pumps five million, has long-term spare capacity—and with it the real ability to influence world oil prices.

Hussein: more turmoil to come?

The Saudis have often been a moderating influence on prices, free under Western aegis to pursue market stability even when it angered OPEC's more militarily potent price hawks such as Iraq and Iran. The U.S. response to the Kuwait invasion must be of a nature to convince the Saudis that they are still safe from invasion from the north. If the response is anything less, says Melvin Conant, a consultant in Washington who specializes in the geopolitics of energy, Saudi Arabia will be pried out of the Western orbit and "the Gulf will be in turmoil for a long, long time."

Forging an effective response will not be easy if Iraq plays it relatively cool and keeps the oil flowing. The invasion did not effectively alter the balance of supply and demand. OPEC's production-sharing agreement, forged two days before the invasion, would have raised the target price of oil from $18 to $21 by year's end in any case, even allowing for some cheating.

If Hussein threatens further aggression, he has some glaring weaknesses that might be his downfall. All of Iraq's oil production, which comprises about 50% of the country's GNP, passes to world markets through three very narrow and vulnerable outlets. About 55% travels through Turkey by pipeline; another 30% crosses Saudi Arabia by pipeline; the rest goes through the Strait of Hormuz by tanker. So far, Hussein has exploited his strategic position at the center of the world's richest oil region. But a man in the center is also a man surrounded, and Iraq cannot long function without the good will of its neighbors. **– Peter Nulty**



Crude: more gyrations ahead?

TAXES: POLITICS VS. COMMON SENSE

■ "That dog won't hunt." That's the way a senior strategist for the House Ways and Means Committee assesses the prospects for an Administration proposal to raise taxes on upper-income taxpayers by limiting the deductibility of state and local taxes to $10,000.

The idea, hatched by Budget Director Richard Darman, was to defuse Democratic concerns that increased excise taxes (on beer and wine, for example) would hurt the poor and a lower capital gains rate (President Bush's beloved proposal) would help the rich. Excise tax increases, capital gains cuts, and limits on deductions for upper-income taxpayers could be combined in such a way that there would be little change in the overall distribution of the tax burden. So why not do it? Politics.

Powerful Democrats from high-tax states, like New York Governor Mario Cuomo, adamantly oppose any change in local income tax deductibility. And Democratic congressional leaders—including Senate Majority Leader George Mitchell of Maine—insist that the fair way to pay for a capital gains cut is to raise individual income taxes.

Behind the scenes, Administration strategists may have considered just such a trade. But they would face a tough fight with key congressional Republicans like Senator Phil Gramm, a staunch capital gains cut advocate. Says Gramm: "I won't vote to raise marginal rates. Period."

Ultimately, predicts one Administration insider, both sides will "nuke each other," thereby destroying prospects for a capital gains cut this year. The Republicans' fallback: indexing capital gains for inflation. That way, the elderly selling their homes, for example, would be taxed on real, not inflated, gains. That dog could hunt darn well. **– Ann Reilly Dowd**

EXECS TAKE ON THE ELEMENTS

■ Looking for a sport that's absolutely, positively upscale? Try windsurfing. The basic hull and sail cost around $1,000, and a full course of instruction $75. More important, proficiency implies not only spare time but easy access to a lake or ocean as well. More than one million Americans are hooked on this gusty summer sport, and the number of new enthusiasts is growing. Says Brian Little, 48, a founding partner of the buyout firm **Forstmann Little** and a windsurfer since 1983: "It's just you and the elements." Other windsurfing execs include billionaire Jay Pritzker, 68, chairman of **Hyatt**; Joel Alvord, 51, CEO of **Shawmut National**, a bank holding company in Hartford; and Eric Gleacher, 50, CEO of the investment firm **Gleacher & Co.**

It's not all easy sailing. Says Gleacher: "You can fall a lot in the beginning." **– Kate Ballen**

ANTHONY NESTE

Brian Little at sea off Montauk, New York

TANDY ENTERS HOME COMPUTER RACE

■ In the three years prior to bringing **Tandy**'s new home PC to market, company engineers and everybody else involved in the development called it Project Jean. Jean is the wife of Tandy CEO John V. Roach, who'd told his people to come up with a computer that she could use. Her understandably biased verdict: "It's so easy it's like working a television."

Tandy joins **IBM** in the race against **Apple Computer** for a share in the U.S. home computer market—if there is such a thing. To some extent, all these companies are chasing customers who are intimidated by PCs and who probably don't even need one.

Tandy, IBM, and Apple have different concepts of a home computer. The Apple II is often marketed as a learning tool for children, offering educational software along with home business programs. Price range: $859 to $2,506, depending on hardware and software options. IBM's PS/1 is more advanced: Its mid-range speed and power and teach-as-you-go software are aimed at first-time users, but not necessarily children. Price: $999 to $1,999.

The big strength of Tandy's 1000 RL is software for relative technophobes who want to computerize such household tasks as budget keeping and shopping. The software includes a grocery list that organizes items by category, dairy and meat, for example. There is a cookbook. Each recipe lists all the ingredients needed. The PC owner uses the mouse to indicate which ones aren't in the pantry, and the PC adds them to the shopping list automatically. There's also a travel planner that includes a packing list for five trips, including a Caribbean cruise. Instead of posting messages on the refrigerator, family members can leave them on the Tandy. No wonder the Roaches keep their 1000 RL in the kitchen of their Fort Worth home. Price for hardware and software: $750 to $1,560, depending on options.

Tandy will sell the 1000 RL through its 7,034 Radio Shack stores, the biggest electronics chain in the world. IBM is relying on department stores like Sears, as well as its authorized dealers, to get the PS/1 into the hands of the buyer. Will either knock Apple, which distributes through authorized dealers, off its home computer pedestal? No, says David Korus, a Kidder Peabody analyst. As for the other two, says he: "Long term, IBM will have a stronger home franchise than Tandy." **– Stephanie Losee**

At home: the Roaches and their PC

DANNY TURNER

THE S&L BAILOUT: HOW MUCH, REALLY?

■ The Treasury Department, which last summer put a $73 billion pricetag on the S&L disaster, has increased its estimate to between $90 billion and $130 billion. Over the same period, the General Accounting Office has revised its number from $257 billion to $325

Another cost estimate: $1.4 trillion

billion. GAO even has a worst-case scenario hinged on a slumping economy and an even weaker real estate market that together would push the cost up to $500 billion.

These days a few billion is only a few billion, but how come such disparity? Answer: Treasury's figures are wishful thinking. They exclude interest costs on the money the government will need to borrow to pay the principal. GAO's figures include them (see chart).

There may be worse to come. *Stanford Law & Policy Review*, a university publication, recently came up with an even more mind-boggling total. It thinks the government has underestimated the number of S&Ls that are in trouble. The magazine's estimate of the final figure: $1.4 trillion. **– Rick Tetzeli**

HOW SAFE IS YOUR MONEY IN THE BANK?

■ Last year 206 commercial banks went bankrupt, and some 200 more may collapse in 1990. So says William Seidman, 69, chairman of the Federal Deposit Insurance Corp. In 1989 the FDIC spent $851 million on bailouts, handing the cash to depositors and to the banks themselves to put them in better shape for interested buyers. It expects to hand out at least another $2 billion by the end of 1990.

All this will reduce its total funds to $11 billion, compared with $18.3 billion on hand in 1987. Says Seidman: "The fund is under considerable stress and is at the lowest point at any time in modern history."

Is another S&L crisis on its way? Some problems faced by failed and troubled commercial banks are eerily similar to those that hit the thrifts: bad real estate loans in Texas and the Northeast, for example. (For a look at how the FDIC operated in Texas, see Money & Markets.) The majority of banking experts say commercial banks are in far better condition than S&Ls because they have been more tightly supervised. Besides, if the FDIC decides to save the fund with a big increase in premiums, banks could afford them. Says Lowell Bryan, a director of the McKinsey consulting firm: "Even if the fund goes into the red temporarily during a recession, the industry has $212 billion of equity capital" to draw on.

Meantime, Congress may try to head off danger by limiting the FDIC's coverage to $100,000 per depositor. Currently there is no real ceiling on FDIC insurance: Those who spread their money among different banks and types of accounts get insurance of up to $100,000 on each of them. **– K.B.**

Seidman: "Under considerable stress"

WAY TO GO, KEN!

■ Poor Barbie. Something's happened to Ken, her cohort and escort for the past 29 years. Carina Guillot, 43, a nurse from Tinton Falls, New Jersey, bought a Ken doll during a visit to Tampa and found he was decked out like Barbie (see photo). Guillot's reaction: "Oh, my God! Now we have a cross-dressed Ken!"

Manufacturer **Mattel** blames the kinky Ken on "product tampering" but has no idea where. The store manager offered to exchange the $8.99 doll. Guillot declined. She and daughter Jocelyn, 12, collect Barbies and Kens, and since no other cross-dressers have emerged, she thinks this Ken may be very valuable. **– K.B.**

UAW WORKERS 'DISLIKE GM MOST'

■ The United Auto Workers seems to be on a collision course with the Big Three automakers as contract talks begin. Although the current three-year pact doesn't expire until 11:59 P.M. September 14, at least one auto analyst is already predicting a strike. Says Ron Glantz of Dean Witter Reynolds: "The rank and file are more militant than anytime since the 1970s. There will be a strike almost no matter what." The likely target, says Glantz: "GM. That's the company they dislike the most." The UAW says GM broke the job security terms of the last contract by idling three of its plants; an independent arbitrator ruled in favor of GM.

The Big Three aren't in any condition for a walkout. All posted sharp declines in second-quarter earnings. At **General Motors**, profits fell 38% to $900 million; at **Ford**, 45% to $771 million; and at **Chrysler**, 47% to $180 million. Earnings have been partly battered by a vicious cycle of expensive incentives as the automakers try to stem a falloff in orders for new cars. (See following story for one reason fewer Americans may be buying them.)

Glantz says the expected strike probably won't last for more than two weeks. In the face of competition from Japanese automakers, a longer strike would be self-defeating for the union—any further loss of market share equals more lost jobs. After a fortnight on picket lines, Glantz says, union members will go back with modest pay increases and "a feeling that the UAW did everything it could." **– Mark Alpert**

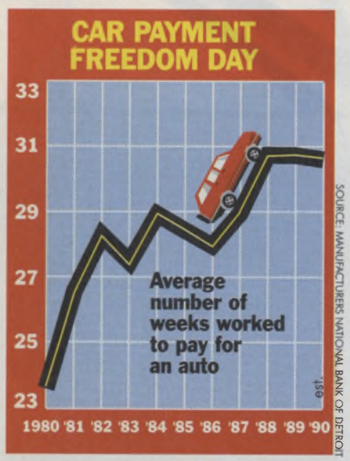
Who's been messing with Ken?

A view of Laughlin, Nevada, where tourists spent $346 million in 1989

THE VROOMING COST OF A NEW CAR

■ If you think more and more of your salary is going toward the new family buggy, you are right. A recent study by Manufacturers National Bank of Detroit finds that the average American family has to spend seven months of its annual income to buy a new car, vs. five months in 1980. (See chart for how the cost of a car, which includes finance charges, has climbed over the past decade.)

Economist David Sowerby, the study's author, blames the increased auto costs on higher borrowing rates, import restraints that stifled competition, and such expensive options as power steering. He also says cars cost $1,000 more because of safety and environmental legislation, which sets such things as emission and fuel-consumption standards. Sowerby believes even tougher rules in the clean air bill, expected to be enacted this year, could add another $700 to a car's price over three years. Says he: "There appears to be no end in sight." Other than never buying another new car, that is. **– K.B.**



Here's one reason for fewer car sales.

WHERE IT HURTS LESS TO LOSE

■ Quick: Name the three biggest gambling cities in Nevada. Las Vegas, Reno, and Lake Tahoe, right? Wanna bet?

You'd lose. No. 3 is Laughlin (pop. 5,000), an old-fashioned Mojave Desert town on the banks of the Colorado River. It attracted nearly four million tourists and rang up $346 million in gaming revenues in 1989, knocking Lake Tahoe into fourth place.

Laughlin—named for Las Vegas émigré and former nightclub owner Don Laughlin, now 59, who bought a bankrupt bar there in 1966—has few services: It shares a general aviation airport with Bullhead City, Arizona, across the river, and borrows police and firefighters from Las Vegas, 90 miles north. But with the gala August opening of the $190 million Flamingo Hilton Laughlin, the town now boasts 7,200 hotel rooms—average price: $30 per night—and nine casinos, including Harrah's, Circus Circus, Ramada, Golden Nugget, and the Riverside Resort, Don Laughlin's place.

Gaming giants come to Laughlin in pursuit of the gallivanting gray-bird market: 71% of the town's visitors are over 50, and nearly half are retired. To cater to these folks, the Flamingo Hilton guarantees that 80% of its slot machines have stools. Low rollers eat up Laughlin's folksy atmosphere, which they compare to the old, pre-glitz Las Vegas. Says Ted Henry, 42, a vice president of a **Winnebago** subsidiary and a frequent visitor: "You almost don't mind giving your money to them." **– Nancy J. Perry**

A BODY BLOW FOR INTERLEUKIN-2

■ A sufferer from kidney cancer, an especially vicious form of the disease that until recently had failed to respond to any drug, might well ask, "Whose side are those guys on?"

"Those guys" are the nine doctors on the committee that advises the FDA on which new drugs to approve—and which to keep from the U.S. market. The FDA is likely to go along with the recommendations.

The drug that won't be sold anytime soon: **Cetus**'s kidney-cancer-treating Interleukin-2 (IL-2), which the company hoped would become its first big commercial product. The advisory committee pointed out that IL-2 is effective in shrinking tumors in only about 15% of patients and results in total remission in only 4% of its users, which is true.

But it also said the often severe side effects, including heart palpitations and swelling of the lungs, outweigh the advantages of IL-2. That makes no sense. When nothing else works, why kill the only hope? Not to mention the company.

The committee wants Cetus to pinpoint the type of patient who will respond to IL-2. Given biology's complexities, this could delay IL-2's introduction for years and cripple Cetus in the process. The Emeryville, California, company has lost money in each of the past four years. The committee's ruling knocked Cetus stock down from $15 to $10 a share. Cetus has $163 million in cash. But long-term R&D—on which it spent $49 million in 1989, vs. $25 million in revenues—may be beyond its financial reach. **– Gene Bylinsky**

NOW HEAR THIS

■ **JACOBUS DE SWARDT,** 27, a white South African sociologist, on why he has agreed to be chairman of the Cape Town Central branch of the militant, largely black African National Congress:
"I now see myself first as an African and not an Afrikaner."

■ **QUSARN SESSION,** 11, on the risk of being killed by random bullets in New York City:
"There's nothing to be afraid of. If you're not in the wrong place at the wrong time, you'll be OK."

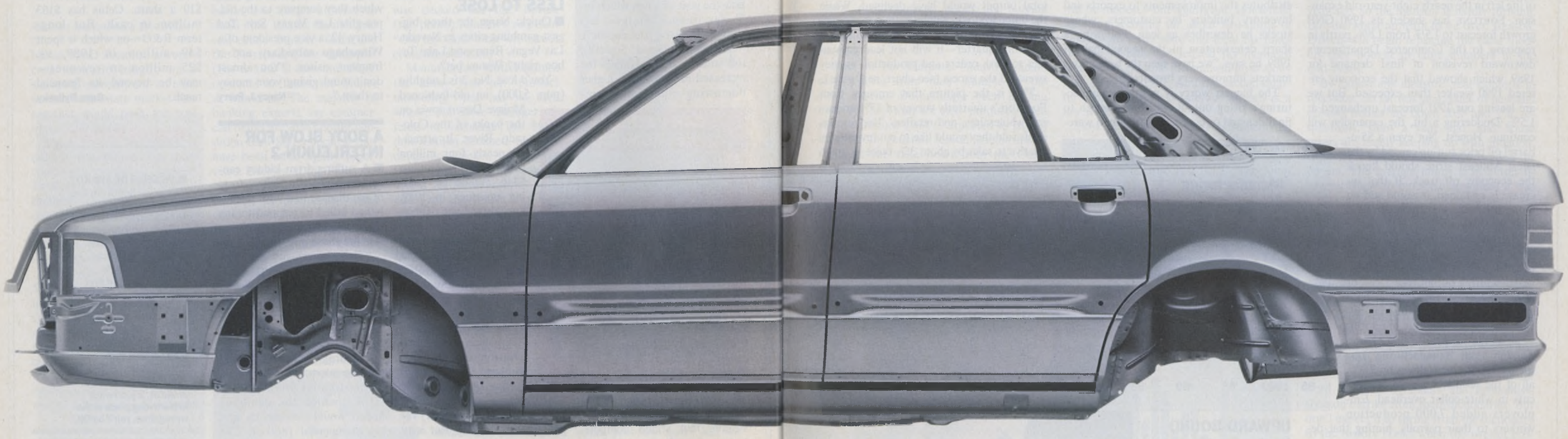
■ **DAVID SHAMBAUGH,** 37, a University of London Sinologist, on Taiwan's increasing investment in China:
"Taiwan is no longer trying to recover the mainland. It's trying to buy it back."

Sell-by date: endof the year 2000.

Surely a car which incorporates the height of high technology, outstanding exterior design and ergonomics, a powerful engine, a finely developed drive system and high reserves of safety deserves to be preserved as long as possible. Which perhaps explains why Audi zinc galvanises the bodies of all its saloons and coupés. Galvanisation is recognised as the best protection of all against corrosion. For example, should the paintwork be damaged by stone chipping, the zinc "heals" itself and the steel remains unaffected. Not surprisingly, Audi offers a 10-year guarantee against rusting through of the bodywork.

Which should see you nicely into the next millenium, even if you bought today.

Audi Vorsprung durch Technik



BY JOSEPH SPIERS

THIS SHAKY OLD EXPANSION IS STEADIER THAN IT LOOKS

■ If there's one thing the economy is producing lots of lately, it's bad news. Factory employment has dropped in nearly every month this year, pushing the total of manufacturing jobs down by 136,000 through July. Housing starts are their lowest since 1982. Businesses have been reporting weak profits all year. The Commerce Department's latest GNP figures showed second-quarter growth slow enough to raise recession fears.

But take a closer look: There's still plenty of life left in the nearly eight-year-old expansion. FORTUNE has shaded its 1990 GNP growth forecast to 1.5% from 1.8%, partly in response to the Commerce Department's downward revision of final demand for 1989, which showed that the economy entered 1990 weaker than expected. But we are leaving our 1991 forecast unchanged at 1.5%. Doddering a bit, the expansion will continue. Honest. Not even a $5-a-barrel oil price run-up caused by the latest Mideast strife should knock the economy off track. If that increase is sustained, it would add no more than half a percentage point to inflation this year.

The underlying health of manufacturing gives cause for tempered optimism. From December to June, manufacturing output rose 1.7%, or at a respectable 3.5% annual pace (see chart). And the industrial employment figures for July are not as weak as they appear at first glance. Though total manufacturing jobs for the month were down by 7,000, all of the reductions came through cuts in white-collar overhead. Employers added 7,000 production workers to their payrolls, hinting that demand is firm.

Rising output in the chemical industry is an important signal that manufacturing's strength runs deep. U.S. companies are lifting production of inorganic chemicals, the fundamental building blocks used in a host of industrial processes. They also increased output of plastics resins by 7.6% in May from a year earlier, pushing year-to-date production up 3.3%.

Given the sorry state of the construction industry, a key market for plastics, it's clear as Lucite that chemicals won't have a banner year. Still, demand for packaging material, the single most important market for resins, is firming. Richard Stuckey, chief economist of Du Pont, also cites pickups in demand for engineering polymers, used in the manufacture of a broad range of products from taillights on cars to valves for aerosol cans. He attributes the improvements to exports and inventory building by customers, whose stocks he describes as lean. Following a sharp deterioration in the second half of 1989, he says, "we have seen the tone of our markets improve very broadly."

The biggest worry is whether manufacturing's rising output will flow through to final demand or continue piling up in warehouses. The Commerce Department's estimate of second-quarter real GNP showed the economy growing at just a 1.2% annual rate, but without inventory accumulation total output would have declined. While the bulge in stocks will be a drag on production for the rest of the year—particularly in the third quarter—it will not lead companies to slash orders and production as they sweat off the excess (see chart, next page).

This is the picture that emerges from FORTUNE's quarterly survey of 175 producers, wholesalers, and retailers. The respondents said they would like to cut inventories relative to sales by about 3%, twice as much as they wanted to trim in the first quarter. At the same time, they continue to expect modest economic growth. They look for their own companies' sales to expand strongly enough to accommodate some additional inventory increase, albeit at a considerably slower pace.

But will final demand pick up? During the second quarter every component of private spending—consumer outlays, business investment, homebuilding, and exports—fell. There were aberrations aplenty in the numbers, however, and FORTUNE expects final sales of goods and services to rebound sufficiently to keep growth on track.

Weaker than expected commercial aircraft sales, for example, explain part of the big slowdown in capital spending. But airframe manufacturers' books are bulging with backlogged orders, pointing to a recovery during the year's second half and beyond.

Sales in the computer industry should also recover from their stumble in the June quarter. Buyers have been holding back as they wait for new products, such as a mainframe IBM is expected to launch in 1991. In general, capital goods manufacturers can take heart from the Commerce Department's upward revision of first-quarter profits. Though earnings were still lower than the year before, the revision indicates that companies are better able to afford to buy more equipment. They cannot afford not to. Strong global competitive pressures should continue to spur new investment.

The second-quarter drop in U.S. merchandise exports, the engine that has powered the economy in recent years, is another temporary setback that resulted in a large deterioration in the trade deficit. FORTUNE expects a resumption of stronger export sales because the economies of America's trading partners are growing briskly. The optimism is borne out by the experience of Parker Hannifin, an industrial components manufacturer based in Cleveland. The company's revenues from exports are up 10% to 15% this year, in part reflecting especially strong demand from South Korea for its air conditioner and construction equipment parts. Says Paul Schloemer, president and CEO: "We expect exports will remain strong because overseas markets are strong."

Any lift the consumer gives the economy will be modest—but significant. Household spending accounts for about two-thirds of GNP. With some state and local tax hikes starting to bite and federal tax increases looming, disposable income will grow slowly in 1990 and 1991. And the second-quarter household savings rate was already at a low 5.1%.

How much deeper can consumers dig into their paychecks? Before adjusting for inflation, spending grew a hefty 1% in June, though income rose just 0.4%. The jump demonstrates that consumers aren't ready to cut living standards yet. But FORTUNE doesn't expect the savings rate to fall much, and we predict that real consumption will grow at a below-average 1.8% yearly rate through 1991.

As with the rest of the economy, consumer markets are spotty. Sales of furniture and appliances are starting to get hit by the slowdown in home sales. Women's clothing, coming off a strong year in 1989, is suffering from a lack of exciting styles. But other areas, such as toys and men's clothing, are doing better.

Domestic autos are picking up speed. Unit sales in July were running at a 7.1 million annual rate, vs. April's depressed 6.6 million level. Sales were still 2% below a year ago, so the industry is hardly thriving. But the worst appears to be over. Reason: Drivers will begin replacing the older models they bought in large numbers in the mid-1980s.

By almost any measure, real estate is in recession. So far this year, sales of new and existing homes are down 10% and 2%, respectively, from a year ago, and house prices are barely keeping up with inflation. But what's bad news for sellers is good for buyers. The average family is in better financial shape to purchase now than it was a year ago, according to the National Association of Realtors' affordability index, and recent sales figures are beginning to reflect that buying power. New-home purchases jumped 8% in June to their highest since February, and existing-home sales registered their first increase in seven months. FORTUNE expects new single-family housing starts to rise by about 100,000 units from their depressed second-quarter level to a one million annual rate by the end of 1991.

"Recession" remains a perfectly useful word that lexicographers and economists shouldn't strike from their dictionaries. But don't expect it to spring from the dictionary to the history books when the overall economic travails of 1990 and 1991 are described in the future. F

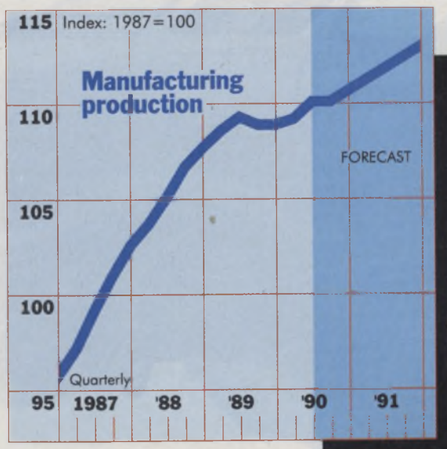
CHIEF ECONOMIST *Todd May Jr.*
SENIOR ECONOMIST *Vivian Brownstein*
STAFF ECONOMIST *Joseph Spiers*
RESEARCH ASSOCIATES *Lenore Schiff and Lorraine Carson*
FORTUNE's forecast is produced by this magazine's economists using our own economic model.

OVERVIEW

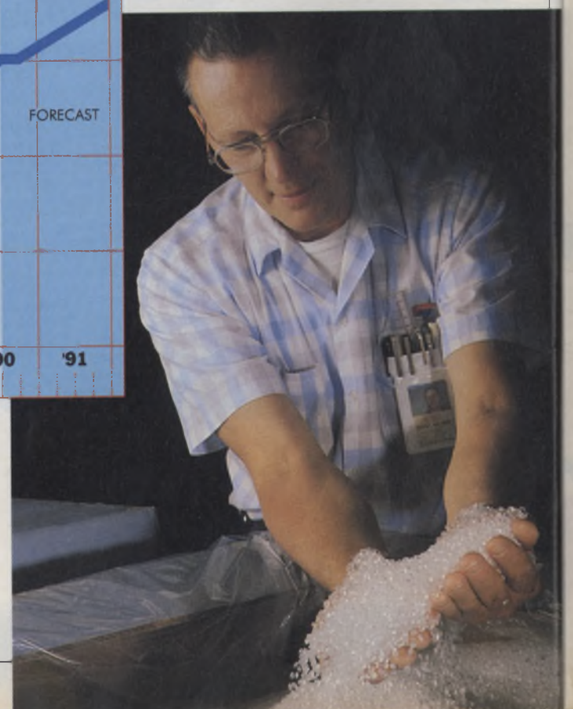
- **Investment, exports, and consumption will rebound.**
- **The inventory jump will lead to slower stock building but not to a slash in output.**
- **While housing remains in recession, the worst is over.**

FORTUNE'S BASIC OUTLOOK

- **Growth: Real GNP will expand 1.5% during both 1990 and 1991.**
- **Inflation: GNP price increases will climb from 4% during 1989 to 5.5% in 1991.**
- **Interest rates: Next year they will be up a percentage point from the spring lows.**



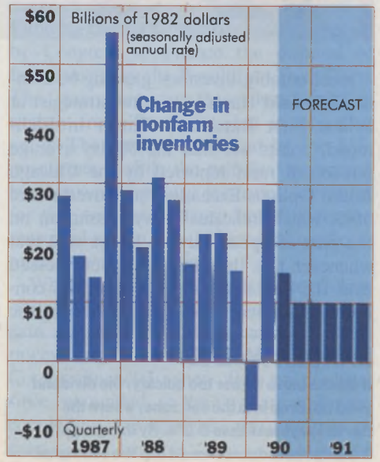
UPWARD BOUND
Manufacturers will keep production rising after a temporary pause to slow inventory building. Growing demand for basic materials, like these Du Pont resins, is supporting overall factory output now.



PHOTOGRAPH BY CHARLIE ARCHAMBAULT

STOCK CLEARANCE

The second-quarter inventory surge hangs ominously over the economy. But final demand will be strong enough to allow producers to reduce stock accumulation gradually.



DON'T WAIT FOR A BIG RALLY, JUST FIND THE RIGHT STOCKS

Stick with equities, but buy carefully, says FORTUNE's quarterly investment guide.

■ Never trust a summer romance. In mid-July the Dow Jones industrial average was flirting with 3000. By early August that magical number was no more than a fading memory. First came earnings disappointments from highflying growth stocks. Then Iraq's tanks rolled into Kuwait, which owns 9% of the world's oil reserves, raising crude prices and fears of inflation. The news sent investors scurrying for cover. Frustration was running high. Moaned a portfolio manager: "My stocks know that I own them, and they hate me."

Though the market could regain some lost ground if political clouds clear, don't expect things to improve greatly anytime soon. Despite the recent pullback, the stock market's value indicators remain near historic highs, so any recovery would be limited. A big barrier to a sustained advance is the dividend yield for Standard & Poor's 500-stock index, which recently stood at 3.6%, above a sell signal but not by much (see chart). According to John Manley, quantitative analyst for Smith Barney, when the yield dips close to 3.2% it's time to lighten up on equities.

One of the market's biggest engines is sputtering. Return on stockholders' equity, which spiraled up in the Eighties, has lately been trending down. Reason: Slow economic growth has heightened competition, making it harder for companies to aggressively raise prices and crimping profits. Analysts at Goldman Sachs expect operating earnings for S&P 500 companies to decline by 5% in 1990.

Another punch in the stomach for ROE is the decline of financial leverage, or the use of debt. Increased leverage tends to push up ROE by focusing profits on a relatively smaller base of equity. Leverage grew mightily in the Eighties and so did ROE, but lately that trend has reversed. Steven Einhorn, investment strategist at Goldman Sachs, expects debt-to-equity ratios to continue falling in the 1990s, which could drag ROE down further still.

In the midst of all this negative news for stocks, some positive signs can be glimpsed —most notably, investors' growing bearishness. Donald Hayes, a market strategist at Wheat First Butcher & Singer in Richmond, points out that the 30-day average put-to-call ratio reported by the Chicago Board Options Exchange has moved above 65%, which indicates heavy pessimism on the part of option buyers. Hayes says that whenever this threshold has been crossed over the past decade, the market has confounded the bears and advanced during the next six months. That's encouraging but hardly justifies raging bullishness.

So which stocks are best in an unsure market? Analysts agree that, despite recent setbacks, growth stocks still offer value and promising prospects. They are persistent growers, even in a slow economy, and they are enticingly cheap relative to the rest of the market, notes Einhorn of Goldman Sachs. He suggests a sprinkling of drug, cosmetic, and retailing stocks, including **Bristol-Myers Squibb**, **Merck**, **Gillette**, **Alberto-Culver**, **the Gap**, and **Wal-Mart Stores**.

Another promising group: the hospital supply and health care sector. "These are some of the few companies that will be able to raise prices for their products and services in this environment," says Suresh Bhirud, chief portfolio strategist with Oppenheimer & Co. For a performance boost, Bhirud prescribes **National Medical Enterprises** and **Humana**. Lucy Olwell, an analyst with Merrill Lynch, agrees and recommends **Baxter International**, the biggest pure play in the field.

Many oil producers should reap a windfall from more expensive crude, and even after the recent rise in these shares, analysts are urging clients to buy. "We have been pounding the table over these stocks," says Michael Young, an oil specialist at Smith Barney. He's recommending the companies with strong domestic production, since their source of oil will remain stable no matter what happens overseas. He likes **Atlantic Richfield**, which pumps 90% of its oil from U.S. soil, up to a price of roughly $140 per share. He also favors **Texaco** up to a price of $75. Analyst Richard Pzena at Sanford C. Bernstein notes that companies with big natural gas supplies should benefit as well from the recent rise in crude, since the price of gas will shadow that of oil. He recommends big gas suppliers like **Amerada Hess** (up to $54) and **Amoco** (to $62).

■ **BONDS**. Someone should distribute Dramamine to bondholders. Early in the year, signs of inflation sent the yield on 30-year Treasuries up a full percentage point to 9%. Then signs of economic weakness drove long-term bond yields down to 8.4%. Now, with higher oil prices fueling inflation fears, bond yields could fly back up.

Hang in there. The effect of higher oil prices on U.S. inflation is not as bad as one might think. FORTUNE estimates that even a $5-per-barrel increase in oil's price would give U.S. inflation a one-time boost of only 0.5%.

Treasury securities offer the best values in the bond market. While other bonds pay higher yields, the advantage has become noticeably slim recently—just 1.3 percentage points for investment-grade corporate bonds and 1.2 percentage points for mortgage-backed securities. That's not enough extra yield to compensate for the additional risk, say bond managers like Vanguard Group's Ian MacKinnon.

For those who seek a more generous payout than Treasuries offer, MacKinnon suggests bonds issued by the **Resolution Funding Corp.** (Refcorp), which was set up by Congress to finance the disposal of failed thrifts by the Resolution Trust Corp. The guarantee on these bonds differs slightly from Treasuries, but it is just as good: The interest is backed by the U.S. government, while the principal is secured by escrowed Treasury securities. In return for that wrinkle, Refcorp bondholders are rewarded with a full 0.32 percentage point of yield over Treasuries.

Whatever your yield targets, steer clear of junk. Yes, these bonds were a great bargain just a few months ago when their prices dove on news of retailer Campeau Corp.'s financial woes. But prices have since rebounded, so the buys are no longer compelling and the risks are as great as ever.

continued

WHAT THE HECK DO I DO NOW?

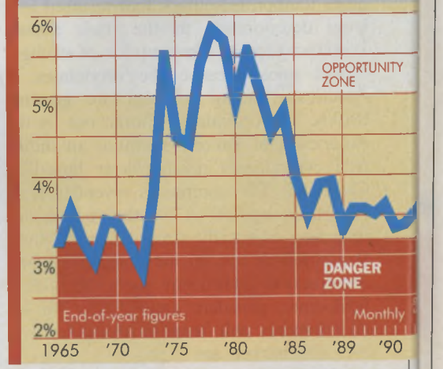
STOCKS
■ **Shares are too pricey to sustain a major advance. After a recent pullback, growth stocks are a great buy.**

BONDS
■ **Higher inflation will hurt prices, but don't expect a rout. Treasuries and munis look good. Avoid the junk market.**

REAL ESTATE
■ **Returns are still tumbling, though a bottom may be near. The safest bets are REITs that own shopping malls.**

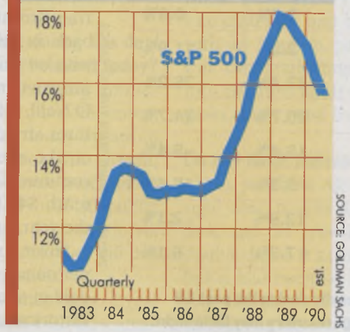
COMMODITIES
■ **Precious metals are perking up. Gold is a better bet than silver. Among the grains, corn holds promise for a fall rally.**

DIVIDEND YIELD ON S&P 500



DANGER AHEAD
If stocks move higher too quickly, the dividend yield will drop into the sell zone, where the market pays less than 3.2%. By this gauge, a 14% market advance would trip the sell signal.

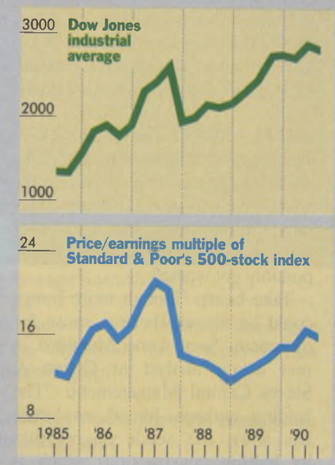
RETURN ON EQUITY



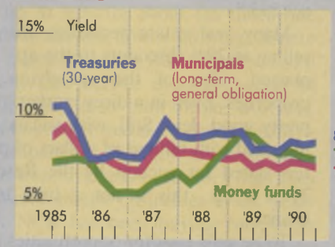
Return on stockholders' equity, a prime mover of stocks, has been falling for a year.

STATE OF THE MARKETS

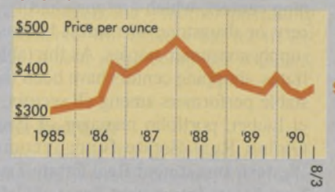
Stocks



Bonds



Gold



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This is FORTUNE's fortnightly look at the major markets of the past five years.

CHARTS SHOW END-OF-QUARTER FIGURES.

BASED ON EARNINGS FOR THE LATEST FOUR QUARTERS.

SOURCES: STANDARD & POOR'S, BOND BUYER, DONOGHUE'S MONEY FUND REPORT, COMMODITY EXCHANGE

The prospect of a federal tax increase has strengthened the case for tax-exempt municipal bonds. But with many states and municipalities also in a fiscal bind, investors should choose carefully. Peter Hegel of Van Kampen Merritt in Lisle, Illinois, is sticking with triple-A issues, which yield only 0.15 percentage point less than single-A bonds. Two on his buy list are **Chicago Public Building Commission** 7% bonds due 1/1/2015 and **Palm Beach Criminal Justice** 7.2% bonds due 6/1/15. Both yield about 7%.

■ **REAL ESTATE.** The Southwest is saddled with properties from hundreds of busted thrifts; the Northeast is plagued by a slumping economy; the Northwest stands to suffer from defense cuts. Could things possibly get worse?

Take heart. Though more lumps could lie ahead, there is cause for optimism. Says Anne Mengden, a real estate analyst at Cohen & Steers Capital Management: "The lending cutback forced on banks has sown the seeds of recovery by halting construction, which is what the real estate market really needed."

Many real estate securities are selling at 20% discounts to the appraised value of the underlying properties. Even in a dicey market, that's a pretty good deal. Still, with vacancy rates high and with billions of dollars of properties slated for auction by the Resolution Trust Corp., this is not a time to take chances.

To be safe, look for opportunities among shopping center REITs. Community shopping centers, which are anchored by a grocery or drugstore, are safest because they supply consumer staples. As the table illustrates, shopping centers have been the most stable performers among all sectors. Samuel Lieber, portfolio manager of Evergreen Global Real Estate fund, recommends **Western Investment Real Estate Trust** and **Real Estate Investment Trust of California** (Reitcal), two REITs that invest in California shopping centers. Western Investment has almost no debt and a strong cash position, and holds properties around fast-growing Sacramento, the state capital. It yields 8.8%. Reitcal holds established, well-managed shopping centers in secure locations like Ventura and Valencia. It yields a juicy 9.7%.

Health care REITs, although down a bit in recent months, should do well over the long run, and not simply because America is getting older. There isn't much chance of glutting the health care facility market, because a certificate of need—that is, proof that an area requires a facility—is usually required by the state before a builder can proceed. Jon Fosheim, a principal at Green Street Advisers in Newport Beach, California, likes **Health Care Properties** REIT, which yields 9.5%.

REAL ESTATE PERFORMANCE

SECTOR	TOTAL RETURN 1989	TOTAL RETURN 1990 first half
Shopping centers	9.7%	0.9%
Office buildings	2.2%	-11.9%
Commercial mortgages	-23.4%	-26.2%
Land development	-20.7%	-24.7%
Industrial buildings	-15.4%	-5.4%
Hotels	-5.5%	-15.4%
Health care facilities	12.8%	-2.1%
Residential mortgages	-7.3%	6.1%

SOURCE: COHEN & STEERS CAPITAL MANAGEMENT

Real estate securities have lost a bundle during the past 18 months, though analysts are saying a recovery may be in sight.

The performance of REITs that invest in mortgages usually depends on interest rate movements. But the bankruptcy in April of Mortgage & Realty Trust, a REIT that owns commercial mortgages, sent that sector tumbling (see table). Because commercial loan problems could persist, residential mortgage REITs are considered to be a sounder investment.

Analysts expect the returns on office buildings to improve due to the decline in new construction, but don't hold your breath. High vacancy rates will keep returns modest for years. One exception: **Rockefeller Center Properties**, the REIT that owns a convertible mortgage on Rockefeller Center in New York City. The mortgage can convert to a 71.5% equity stake in Rockefeller Center in the year 2000. The depressed real estate market in Manhattan has sent the REIT's shares to $17.63, a 52-week low. That makes it a bargain for Green Street's Fosheim, especially since trophy properties like Rockefeller Center continue to do well even in down markets. Says Fosheim: "If the New York market went to hell in a hand basket, Rockefeller Center would still be the first choice of most prospective tenants." A 10.7% yield makes this REIT all the more enticing.

■ **COMMODITIES.** True goldbugs love bad news, and the Iraq-Kuwait conflict elicited a strong buy signal from most precious-metals analysts. In early trading on the day after the invasion, gold rocketed more than $8 an ounce. "Gold's response to the Iraq-Kuwait situation shows that it is back in its traditional relationship with oil prices, military actions, and interest rates," notes William O'Neill, Merrill Lynch's senior futures strategist. With each of these on the rise, he expects the rally to continue. O'Neill thinks gold should reach $420 an ounce by the end of the year, up from a recent $377.

Silver looks cheap now at $4.90 per ounce, which puts it in a ratio to gold of about 76 to 1, wider than the historical average of 60 to 1. Even so, silver may not be the best way to play a rally in precious metals. Notes Jeffrey Christian, a managing director of CPM Group, a metals advisory firm in New York: "Silver continues to be spurned by investors who got hurt a decade ago when prices collapsed after a speculative run. Gold is a better bet."

Ideal weather conditions out in the heartland have been depressing grain prices all season. Corn is the one grain with good price prospects, since the U.S. is the only major supplier: Other grains face significant overseas competition. Joel Karlin, a grain analyst at Research Department Inc. in Chicago, sees December corn slipping to $2.30 a bushel by September, at which point he considers it a buy. In the autumn, as seasonal demand kicks in, corn should get as high as an elephant's eye, or about $2.75.

This report was written by Andrew Evan Serwer (stocks), Joshua Mendes (bonds), and Karen Nickel (real estate, commodities).

PORTFOLIO TALK

SCORING BIG WITH CASH COWS

■ Some investors scrutinize stocks for high earnings growth, low P/Es, or hefty dividends. Not Kenneth Hackel, 39, president of Systematic Financial Management in Fort Lee, New Jersey. Hackel hunts for companies that produce cascades of cash. His knack for finding cash-rich companies is so good dealmakers often turn to him for advice on potential takeover targets. Hackel's methods have produced terrific results for his money management clients as well. Over the past decade his picks have handily outpaced Standard & Poor's 500-stock index. Hackel recently dropped by FORTUNE's offices to reveal his latest finds to associate editor Andrew Serwer.

Cash flow analysis was big during the deal days of the 1980s, but is it relevant today?

I strongly believe that analyzing entities for free cash flow is going to become more, not less, important. I think today we are in a period of much slower economic growth, so debt repayment will become much more difficult. Currently only 30% of all public companies can repay their debt within six years from free cash flow. Investors will pay a premium for these companies.

Also, as more money managers invest abroad, they will have to use cash flow analysis because accounting standards country by country are different, so earnings comparisons are often unreliable.

Does everyone view free cash flow the same way?

No. I have found that there are a lot of naive definitions of free cash flow. To start, we convert a company's financial statements from accrual accounting to cash accounting. This simply means that we count as cash only those earnings that a company actually puts in its pocket. Then we add in many possible sources of cash, such as trimming excessive R&D budgets, or "hidden" resources, such as cash accounts that are not otherwise reflected on the balance sheet.

Which stocks are gushing free cash now?

The cheapest stock in our database and our largest holding is **Meredith Corp.**, the publishing company that puts out *Ladies' Home Journal*, *Better Homes and Gardens*, and some trade publications. The stock sells for 7.5 times free cash flow, way below the market's multiple of about 20. We rarely see a company sell so cheap without either a major stock repurchase or a takeover bid, although here the Meredith family has a controlling interest. Still, the family may want to sell. Free cash flow has grown at 13% annually over the past eight years. Meredith could pay off its debt in just one year.

Aren't publishers in a slump?

We are seeing some sluggishness in publishing, but Meredith and the **New York Times**, which we also own, are overly punished. New York Times sells for 12 times free cash flow and has a monopoly position with its flagship paper. Cash flow growth will eventually improve as the industry's fortunes turn up. It can repay its debt in 3.5 years solely from free cash flow.

Do any basic industry stocks look good?

Yes, we think **Alcoa** is a very cheap stock right now. It sells for eight times free cash flow, and the growth of cash flow is in the double digits. It's true that growth is slowing, but it had been so high over the past four years that even if it drops a bit, the stock is still very attractive. I think this will be a great stock over the next three to five years.

Another stock that has some association with basic industry is **Measurex**, which designs and manufactures controls for plants primarily in the paper business. After a bit of weakness this year because of a slowdown in paper, Measurex should generate very strong cash flow over the next four years as paper companies hike their capital spending budgets. We also expect a pickup in orders from Europe. The stock sells for 11 times free cash flow. Harnischfeger Industries, a maker of industrial equipment, recently announced it was buying 20% of the company's shares, and I wouldn't be surprised if someone else stepped in. Measurex has averaged 12% free cash flow growth and can pay off its debt in three or four months.

Do you also look for companies with zero debt?

It's not a prerequisite, though an operation without debt is always more attractive. One we like is **Roadway Express**, the trucking company. It sells for nine times free cash flow, with steady but slow growth that we see picking up.

DAN WINTERS

Money manager Kenneth Hackel

Do technology stocks generate enough free cash to attract you?

Not generally, but I have liked **NCR** for quite a while, and the stock has begun to wake up. It sells for about ten times free cash flow, and the flow is growing, despite heavy expenditures on R&D. This is also a company that derives a good portion of revenue and cash flow from overseas. That's important because I believe American companies will enjoy much stronger growth from overseas businesses than they will from domestic businesses in the years ahead. NCR has been buying back large chunks of its shares. If it keeps up the buyback, pretty soon this company won't have any stock outstanding. Another possibility is that someone will make a bid for it. Either way, it is a great computer company to own.

Any other favorites?

We are looking for a turnaround from **New England Business Service**, which sells business forms. The stock hit the skids this year when its growth rate went from positive to negative, but it sells for only 13 times free cash, and we think it will get back on track next year. It has spent heavily to expand overseas, but now those expenses are behind it, so earnings should pick up. F

Singapore Airlines introduces Raffles Class.

(It's more than just Business as usual.)

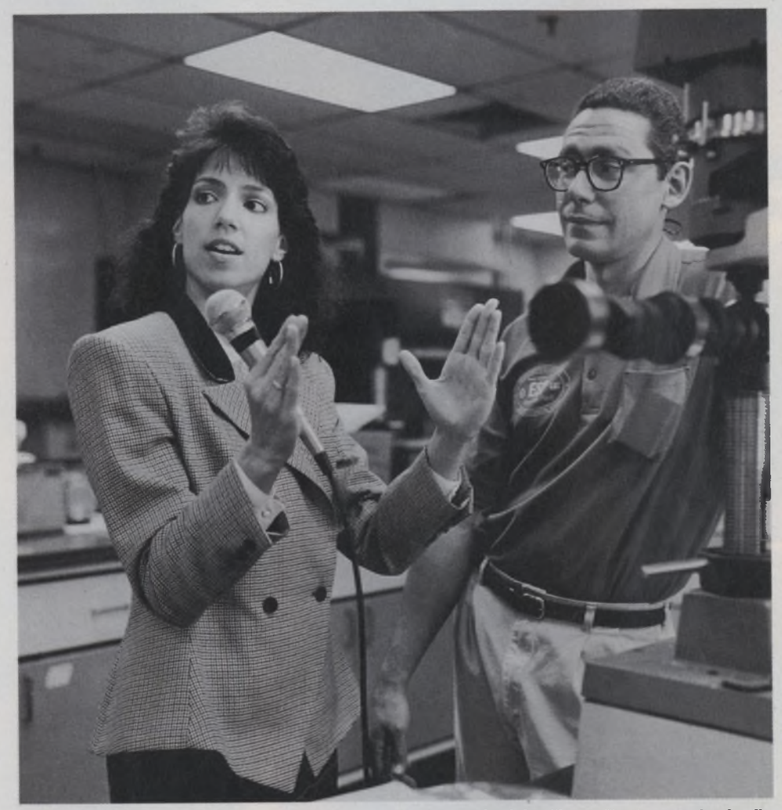
We don't have a Business Class anymore. Instead, we have Raffles Class. Where gentlemen can freshen-up with toiletries by Nina Ricci Elizabeth Arden for our lady passengers. In an ambience that says it's more than just business as usual.

SINGAPORE AIRLINES

3S90

WHAT 25-YEAR-OLDS WANT

Here come the baby-busters, and they are nothing at all like the workaholic yuppies who preceded them. The new crew have been known to turn down big promotions or to quickly acquire clout and then give it all up for leisure. Meet the Employees Who *Can* Say No. ■ *by Alan Deutschman*



Caterpillar's Angela Azzaretti already passed up two higher-paying jobs: "I can afford to be selective."

ANGELA AZZARETTI, 25, the daughter of Italian immigrants, was graduated from the University of Illinois and took a job at Caterpillar's headquarters in Peoria during the summer of 1987. Angela's was the first generation of her Chicago family to go to college, and she was first to work for a FORTUNE 500 company. Caterpillar trained her for a year, with jobs in marketing and manufacturing, and then assigned her to the heavy-duty engine plant in Mossville, Illinois, as the "plant communicator." She wrote speeches for the division's top executives, published the plant newsletter, and produced videotapes viewed by 5,200 workers and managers at monthly meetings.

Her work played well in Mossville, near Peoria, and soon she was offered a promotion to Caterpillar's headquarters staff. Angela turned it down. Then she was offered another promotion, entailing a move to a different plant. Once again she said no.

"Job satisfaction is the most important thing to me," says Angela. "In those other jobs, I would have had less responsibility, less of a challenge. The only benefit was more money. I know it sounds crazy, but I evaluated the situation. I asked the advice of managers who had been around awhile. They said that ten or 20 years ago it would have been a black mark to turn down those jobs. When the company asks you to go, you go. But in this environment, I feel that I can afford to be selective. There are a lot of opportunities here, especially since we're trying to get more women and minorities into management positions. It's a good time to be my age at a corporation this size."

What, you ask, has gotten into the brains of these kids? Nothing less than a new attitude toward life and work—a quirky individualism that is characteristic of the baby-busters. The leading edge of this smaller, overshadowed generation was born in 1965 (see chart). These babies beat the odds from the *very* beginning—the pill was just coming into widespread use. Now, as the oldest of them reach 25, they are arriving in corporate America and struggling to recast the rules according to their own demands.

REPORTER ASSOCIATE *Deborah S. Cooper*

PHOTOGRAPHS BY ALEN MACWEENEY

These are the Employees Who Can Say No, a novel breed that won't be easily manipulated into workaholism by the traditional lures—money, title, security, and ladder climbing. Let's call them yiffies, for young, individualistic, freedom-minded, and few.

The busters insist on getting satisfaction from their jobs but refuse to make personal sacrifices for the sake of the corporation. Their attitude: Other interests—leisure, family, lifestyle, the pursuit of experience—are as important as work. It's hard to figure out what they think is *most* important. They don't seem to have much sense of themselves as a distinct generation, and they certainly aren't impassioned about political or social issues. Nobody would describe them as a bunch of activists.

Sure, you might want to laugh derisively the first time one of your youngest subordinates tells you he intends to work a mere 40-hour week so he can go scuba diving and learn a non–Indo-European tongue. But don't complain, then, when you can't seem to find another competent molecular biologist or quality-control specialist.

Welcome to the new generation gap. Margaret Regan, a consultant at Towers Perrin, holds focus groups at FORTUNE 500 companies, bringing together employees of all ages. "It's amazing to see how puzzled the different generations are by each other," she says. "There's a real clash of values in the workplace right now. The older managers think that if the shoe doesn't fit, you should wear it and walk funny. The baby-busters say to throw it out and get a new shoe. Their attitude says that *they* are going to make the choices."

Now is probably a good time to walk swiftly toward your human resources department—if you even know where it is—and listen to the experts there. Says Roy Howard, BellSouth's vice president for human resources: "The younger workers coming in now aren't as prone to mold their lives to fit our environment." Glenn Blake, director of employment and management development at General Mills, enlarges on the theme: "There's a stronger sense of balance in their lives. Quality of life is more important to them than it was ten years ago. Morals and even religious values are more evident in these people than in the past."

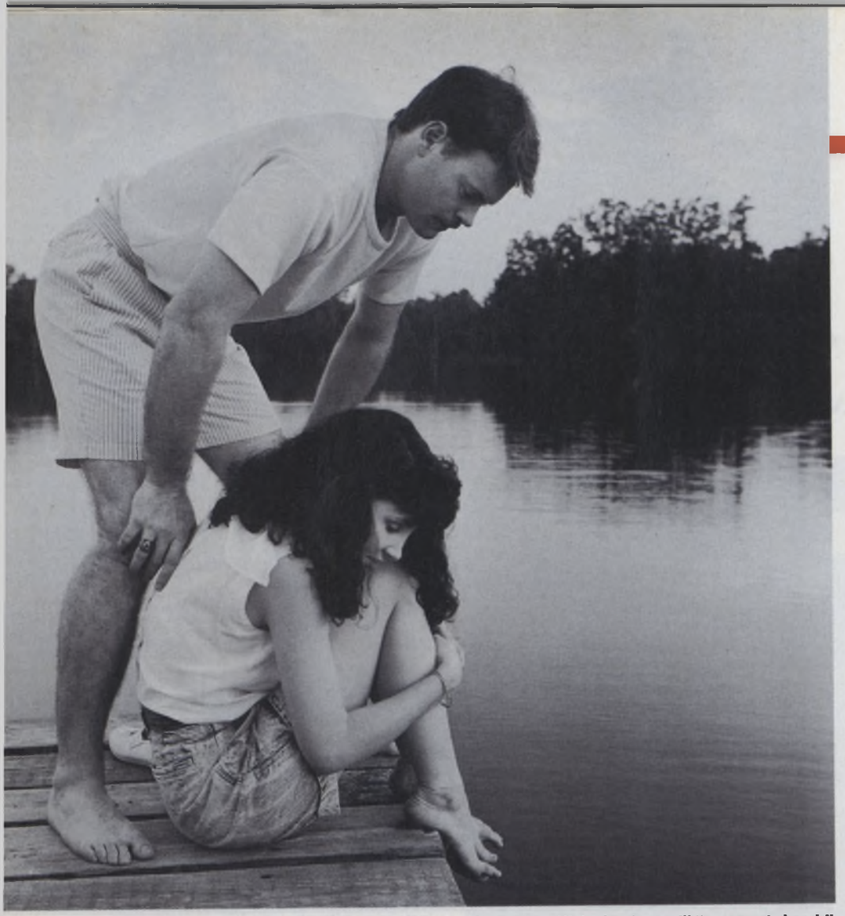
Intel's Aaron Evans is thinking about retiring: "My idea of the good life is time to do things myself."

TO FIND OUT what this generation says about itself, we talked at length with more than 30 college-educated baby-busters who work for FORTUNE 500 companies or professional firms in law, finance, or consulting. All the people interviewed are or will be 25 this year. It's an exercise FORTUNE has undertaken before. We first sampled the opinions of 25-year-old business beginners in 1955, finding those junior Organization Men oddly incurious ("their cultural interests and attainments are strikingly sparse") but quietly confident of a secure and prosperous future within their companies. We repeated the exercise in 1980. At that time, the 25s vaunted their ambitions. Arrogant and impatient, they believed that business offered "the fastest means of gratifying their frankly materialistic requirements." FORTUNE published this portrait of incipient yuppies three years before the term gained currency.

Corporate America's latest legion of recruits sounds very different.

"Just about everyone in my family is tied to the auto industry in one way or another," says Linda Persico. She grew up in the Detroit suburbs and studied mechanical engineering at Michigan State. In 1987 she signed on at Ford Motor Co., where her father has worked as an engineer for 30 years. "I feel guilty for saying this, but I don't feel the kind of loyalty his generation felt. They stayed through thick and thin. I wouldn't feel bad about going outside Ford if that's what was needed to develop my career—but I look around and don't think I could find a better place.

"Maybe a career isn't all it's cracked up to be. It's still important to me, but it's not the No. 1 thing in my life. I have outside interests. Now that I'm engaged [she plans to wed a fellow Ford engineer next year], I'm



Georgia-Pacific's Tim Connell and wife, Lisa: Whoever keeps up with technology will "come out ahead."

more concerned about the time I spend with my fiancé and what it's going to be like after we're married. If it came down to career or relationship, I would have to think that the relationship comes first.

"When I look around and see what people have sacrificed, I'm not sure that a career is the be-all and end-all. I would always like to move up within the company, but not at that price. I would like to be happily married. I see people here who have great careers but are divorced. In the end I don't want to make a great statement as a woman engineer. I want to be happy and contribute in my work. You have to compromise something, and that's an individual choice."

Where do the baby-busters get their odd notions? Their self-absorption and curious brand of purposefulness clearly go back a long way, to college at least. By all accounts, these kids were no campus rebels. If anything, collegiate busters are infected with the virus that social critic Barbara Ehrenreich has called "premature pragmatism," perhaps transmitted from the last cohort of the baby boom. Says Mary Tenopyr, an AT&T recruiting director: "They're serious, dedicated, diligent. Students are thinking about their futures probably more so than at any time since the early Sixties."

BUT DURING their first two or three years in the corporate milieu, a transformation takes place. The busters arrive ready to work hard for a while, well aware of the need to establish a reputation and to move down the learning curve. But then the hellish hours threaten to become chronic—and something happens that rocks the busters' confident outlook.

Call it the boomer backlash. The busters look around the office and observe the 40-ish crowd, bleary-eyed managers who neglect their families and avocations for . . . *what*? By the time the boomers have made it, they've had it. This scares the younger folk no end. "They see the stresses on the generations ahead of them," says consultant Regan. "I see them measuring a lot more. They're assessing things differently. They're much more interested in having a personal life, but they're having trouble figuring out *how* because they see the people ahead of them working 60 to 80 hours a week."

A questioning phase ensues, and yiffies gradually realize that having it all isn't necessarily worth it. This precept, while certainly unoriginal, can be particularly powerful when grasped at 25 rather than 45. Youths who while in college seemed prematurely middle-aged deserve, perhaps, to suffer their midlife crises a bit early.

So the newly enlightened busters begin to make choices. Breaking with a long tradition, these business people seem uncommonly capable of finding ego fulfillment outside the office. Tina Lorance, a quality tester for medical products at 3M in St. Paul, voices a sentiment common to her age cohort: "I want to live a healthy life. I don't want one area monopolizing my time and energy. It's a wellness attitude." She can afford to think that way. She is the youngest microbiologist in a division populated mainly by the 35-to-50 set, so time and circumstance will work in her favor. As they will for many yiffies.

Tim Connell grew up in northern Louisiana and headed toward a totally different world—southern Louisiana—for his college years. He played linebacker at Nicholls State University in Thibodaux, in Cajun country, and earned a degree in manufacturing. "I wanted to get my hands dirty," he says. Georgia-Pacific put him through its management training program—in one assignment, he gave a presentation to CEO Marshall Hahn—and then the company sent him to work on special projects in Arkansas. He settled there and bought a three-bedroom house for about $45,000. Soon he was promoted to assistant superintendent at a plywood plant with 300 workers in Louisville, Mississippi. How did he get this new managerial job? "Someone retired," he says. He replaced a 60-year-old who had moved up from the ranks of hourly production workers.

"Georgia-Pacific is trying to move college-educated people into management positions. They really just started pushing it in the past few years. We have a lot of people retiring, and they have to look for more educated people who have a technical background. Whoever can keep up with the technological advancement is going to come out ahead."

Tim Connell's story isn't unique. The first wave of busters making their way into old-line corporations sometimes find themselves moving into a vacuum. In the Eighties new hiring fell off precipitously at industrial companies beaten back by foreign competition and forced to downsize. The closed-door policy was especially hard on production workers—virtually no new hourly employees were hired by the Big Three automakers in the past decade—but it kept out many white-collar types too. Theirs are the jobs that FORTUNE's sample of yiffies are moving into.

THESE GAPING discontinuities in the corporate lifeline will create opportunities for baby-busters in the coming years. Observes Peter Morrison, a demographer at Rand Corp.: "Some of the more mature industries have a large clump of workers in their 40s and 50s and haven't been adding people in the lower ranks. During the concentrated period of time when the older workers retire or leave, there will be a strong demand for anybody with some skills to replace them."

Once the new recruits make their way into the corporation, won't they be blocked by entrenched hordes of older boomers? No, argues Morrison, "I don't think the congestion on the career ladder will hurt the baby-busters. It's easy to conjure up this image of the large generation ahead of them with all the spots filled. But it's a more dynamic situation. Skills get outmoded rapidly. Someone learned Fortran in the 1970s, but for half the salary you can hire a 25-year-old who knows a more up-to-date computer language."

Eric Jefferson has seen firsthand how far a company will go to develop skilled employees. When he applied for a spot in an AT&T training program in 1983, his résumé showed that he hadn't finished Miami-Dade Community College. He did have some work experience—as a swing-shift manager at McDonald's—and a knack for computers. AT&T paid for his BA in business, which he earned part time at a local college, and the company is now underwriting his MBA. Eric has already risen through six positions. He earns more than $40,000 as a data-processing manager at AT&T in Orlando. He supervises three people, with another six scheduled to come under him by year's end. "With the work force getting older, I think I'm in a prime position," he says.

"When I look at my social group at the company, it's definitely in the 35- to 40-year-old range. My wife is 23. She feels I'm growing up much faster than she is."

Rena Wong was born in Malaysia, and raised in Hong Kong and later in Seattle. Her story could fit right in as a vignette in the novel *The Joy Luck Club*. Rena grew up facing, in her words, "the extraordinarily high expectations of Chinese parents." Her father is a building contractor, her mother a salad chef in a department store's basement restaurant. They expected her to become a doctor or at least a Ph.D. in engineering. Rena stumbled on physics and chemistry courses, but liked math enough to head toward accounting. As a senior at the University of Washington, she was recruited by the Gap, a clothing retailer. She started working as an accountant at the company's San Francisco office in 1987 at $22,000.

Levi Strauss's Rena Wong quit a managerial job "because of stress."

"The Gap's motto was work until you drop," she recalls. The only training at the fast-growing company was intense on-the-job pressure. Soon she was promoted to supervisor and held responsible for six number crunchers. Two years into her career, earning over $30,000 and gaining enviable experience, Rena quit.

"I left because of stress. It's reasonable to work 60 hours a week when you leave school, but not a few years down the road. There was also a question of loyalty. I was working with a woman manager to build our department. But the company was going through a new regime, and when the final cards were down, she didn't stay."

Neither did Rena, who took a job as a cost accountant at Levi Strauss, where she works 40-hour weeks and has the time to tutor a Cantonese-speaking student at a middle school. "You should strive to do your best here," she says, "but this company encourages you to do things that are more fulfilling in life." Rena isn't anyone's supervisor these days, yet she seems content. "I'm quite comfortable now, and I'm not overly ambitious about where I'll be in five or ten or 15 years."

Few collegians seem to comprehend the labor market forces conspiring in their favor. Employers are already preparing for the late 1990s, when they'll be forced to draw from the trough of birth-dearthers. Over the past 20 years, General Mills hired only MBAs for its brand-manager track. This year the company picked college graduates to fill one quarter of the openings. Why? "Demographics, first of all," says Glenn Blake, the management development director, who predicts that competition will heat up for talented recruits. "Looking toward 2000 and beyond, we're going to have to do different things to find our people."

Laurel Cutler, vice president for consumer affairs at Chrysler and vice chairman of the FCB/Leber Katz New York advertising agency, recently talked about careers with a

Linda Persico works at Ford, as her father does: "I don't feel the kind of loyalty his generation felt."

group of seniors at her alma mater, Wellesley. "I was stunned," she says. "These women didn't realize how much in demand they were. They had no idea that it was a buyers' market. Young, well-trained recruits are the shortest supply there is now. For this generation it's easier than it has ever been. The world is their oyster."

Cutler says it was "annoying" and "just awful" to watch the Wellesley seniors sheepishly trudge off to batch-style interviews (the "Next candidate, please" variety) with whichever recruiters came to campus—meaning, for the most part, financial institutions. "Make your own opportunities," she advises. "Do your own thing. Ask what do I want to do, rather than what does somebody else want me to do."

"I would like to have enough time to do a lot of white-water rafting," says Aaron Evans. This Grateful Dead fan went to college in his hometown at the University of Dayton, where he studied electrical engineering. Intel recruited him to become one of the company's 500 "technical sales engineers"—lingo for salesmen who understand microelectronics. The company sent him to a marketing center in Folsom, California, for the 18 months of training needed to learn its entire line of 2,500 products.

Now Aaron is preparing to handle his own sales accounts in the Oakland area. He traded his usual work attire, T-shirts and sandals, for sports jackets and ties to wear on client calls. He's enjoying his company car and the comforts brought by a good salary. And he is already thinking about retiring in a few years to become a teacher.

"I'd like to benefit from my training, earn some good money, bank it away, not buy a house (which is expensive), and then move to Oregon and teach college-prep physics or math." He figures that leading a class of high school seniors would be as rewarding as his current work, and says he's attracted by visions of a rustic setting, a free-spirited lifestyle, and the three months off each year. "My idea of the good life is time to do things myself."

Meanwhile, how does he feel about his career in the corporation? "I may sound greedy, but if I'm going to spend long hours at work here, I want to make a lot of money. I'm not very materialistic—I would be happy eating peanut butter—but I want to enjoy my life, and there will be a day when I'm fed up."

THE MERE MENTION of "materialism" is anathema to the baby-busters. Says Jennifer Schmidt, a Berkeley economics graduate who's going through Prudential's management training program: "I think that this generation has a different vision from the one that preceded it—more green and nature rather than sleeker cars and better toys. It's more about experience than acquisition."

College-educated 25-year-olds who have ensconced themselves in the professional-managerial cadre *can* live fairly well these days—especially if they don't pick a congested metropolitan center. The classic gauge of bourgeois attainment, home ownership, is well within their grasp. Jon Koucky, a computer-programming analyst at Rubbermaid, recently paid $62,500 for a four-bedroom, 19-year-old house located five minutes by car from the company's headquarters in Wooster, Ohio. Eric Jefferson of AT&T and his wife, a claims processor at CNA Insurance, paid $120,000 last year for a four-bedroom home in the Orlando suburbs. With a fireplace.

But a homestead seems unimportant—perhaps even a negative—to many footloose busters. Karen Katz, an engineer at AT&T Bell Labs in Holmdel, New Jersey, rents an apartment in Philadelphia with her husband, a Wharton MBA student. "Owning a home is secondary for us," she says. "Right now we want to experience many different situations, have some freedom and flexibility in our lifestyles. We'll channel our money toward opportunities for travel and growth, getting more involved in the arts, buying sports equipment, and getting out in our environment. Hey, we need good tennis shoes, stuff to go camping—but not a BMW or an oceanfront condo."

The American Dream doesn't exist for the busters as a single, well-defined set of shared aspirations. Visions of the good life are personalized and idiosyncratic. Financial security, harder to come by in this age of the undependable corporation, isn't an overriding concern: The busters invest heavily in their own human capital, confident that their skills and educational credentials will carry them through life. This knowledge-is-power mentality makes them feel untied, free to pursue unpredictable paths.

Many of the obligations of adulthood seem to set in much later these days. Yiffies of the managerial cadre appear a bit awed by the sacrifices their parents made for them—time, attention, money. Marriage is becoming something of an alternative lifestyle, or at least a highly postponable one: For men 25 to 29, 46% have never married, compared with 19% in 1970. For women the change has been even greater: 30% vs. 11%.

Marriage, buster style, looks suspiciously friendly, a formalized sequel to "going out together" rather than a formidable institution. Married busters speak enthusiastically about the arrangement, as if they were the first to discover its benefits. Says Karen Katz of AT&T Bell Laboratories: "Marriage is a good prescription for feeling comfortable in such a pressure-ridden society." Similarly, religion is seen as a useful kind of antistress mechanism. The busters who have faith—a surprisingly large contingent of the people FORTUNE spoke with—tend to talk about religion as a way to add emotional balance and ethical perspective to their lives, rather than as a spiritual discipline or a demanding churchgoing path to salvation.

ASK RICK WATKINS about his aspirations, and one of the first he'll mention is "to play more golf." Rick was a scratch player as a teenager, but chose a career in business over a chance at becoming a professional. After studying economics at the University of Iowa and working at the Federal Reserve of New York, he took an investment banking job at Merrill Lynch in 1988.

There wasn't much time for golf after that. "It was a nonsensical, 100-hour-week, cram-it-down-your-throat, no-social-life world," he says. "There were 30-year-old guys who hadn't had a date since college, and they thought the problem was that they still weren't making enough money. They forgot how to have a date. That scared the hell out of me."

Rick quit after a year, despite assurances from higher-ups that he had the right stuff to follow in their footsteps, with all the lucre and trappings that implied. Now he works for Susquehanna Investment Group, a small firm that serves as a specialist on the New York Stock Exchange. He puts in 40-hour weeks on the floor, where he makes markets in options on Big Board stocks.

"I want to be happy and fulfilled—socially and culturally—and to progress in the work world to the point where I'm happy with myself. I'm not shooting for a title. Titles are bunk. Our generation is much less political in the workplace than the ones that preceded us. I want to earn my place with grace and style, not to lick someone's heels for it."

Perhaps busters lack strong generational self-awareness in part because they haven't been analyzed and targeted as a separate consumer market by Madison Avenue—or explained to themselves by Hollywood. Nobody has made a *Big Chill* or *thirtysomething* about their generation.

The busters have some firsthand recollections of wrenching events like the Watergate hearings, gasoline rationing, and the Iranian hostage crisis. But their strongest collective memory is one they were too young to remember—Vietnam, experienced vicariously through movies, videocassettes, and TV.

Raised in an era of exposés and inside stories, the 25s we interviewed had a hard time naming a contemporary public figure they admire. Their political and economic perspectives, often ill-defined, tend toward the vaguely libertarian or conservative. To this bunch, Uncle Milty was Milton Fried-

Rick Watkins, checking the action on the NYSE options floor, opted off the fast track: "Titles are bunk."

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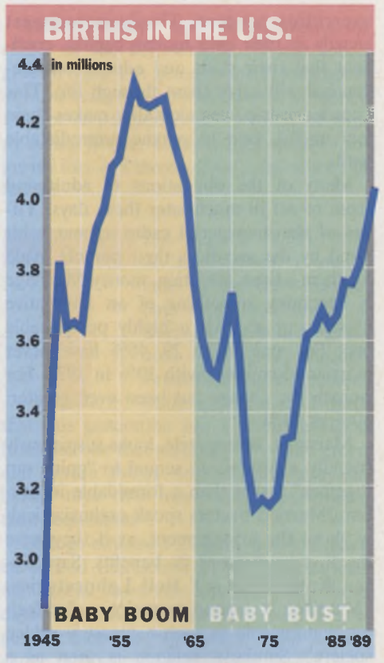

The busters' advantage: The annual baby count dropped below four million in 1965 and didn't climb back up again until last year, when more women in their 30s began to have children.

man. Typically, they voice a wariness about government's efficacy and seem largely uninterested in current affairs.

The more *engagé* of the bunch appear troubled—personally burdened—by the formidable national problems passed on by the "irresponsible" generations that preceded them. The national debt, for example. America's competitiveness. Above all, the environment. That's the one issue that inspires even the most apathetic among the busters, the issue they view as their own.

There's some talk about political activism, but the environmental movement is so broadly appealing because it is accessible to those who aren't inclined to chant slogans or carry placards. The busters feel they can make an impact as discriminating consumers and concerned employees. They plan to "sensitize" their employers to environmental concerns.

So expect them to ask you about waste disposal and toxic emissions. Otherwise, the most progressive ideas you'll hear from the baby-busters will probably be about how they want to progress on home in good time each day. F

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THE BRASH BANKER WHO BOUGHT TEXAS

Hugh McColl built NCNB into the biggest bank in the Lone Star State and the sixth largest in the whole U.S. He's smart, he's bold, and he's the Resolution Trust Corp.'s best customer.

■ *by Gary Hector*

WHEN FEDERAL auctioneers lay down their gavels and call an end to the great sell-off of failed financial institutions, the world of banks and thrifts will be vastly changed. Once prosperous firms will be gone, new alliances will exist, and a fresh generation of powerful bankers will have emerged.

Hugh McColl, 55, combative leader of NCNB Corp., aims to be at the head of that pack. He sure has momentum. NCNB has been on a buying spree since the day it was created in 1960 by a merger of two North Carolina banks. It quickly rose from a distant No. 2 to become the biggest bank in the state, mainly by buying up smaller banks. Under McColl, CEO since 1983, the pace of acquisitions has quickened, with 26 takeovers in just the past three years.

None have done so much to change NCNB's down-home image, and to make the Charlotte bank into a financial powerhouse, as McColl's acquisition of First RepublicBank Corp., the largest and most troubled bank in Texas. First Republic failed with $32.5 billion in assets and potential losses of $3 billion.

When the Federal Deposit Insurance Corp. auctioned First Republic off in 1988, NCNB offered the FDIC a deal that was $700 million better than the next bid, from Wells Fargo Corp. But with tax breaks figured in—breaks that only McColl and his troops knew how to tap—NCNB managed to buy the sprawling Texas franchise for a song. And because the FDIC agreed to take responsibility for most of First Republic's bad loans, NCNB sidestepped the biggest risks. Little wonder bankers are calling McColl's Texas takeover the deal of the century.

McColl also bought 18 other prostrate savings and loans and banks in the Lone Star State, doubling the number of branches there. By March 1990, NCNB's Texas operations claimed a share of the retail banking market 1½ times that of its nearest rival. In its first year under NCNB management, the Texas subsidiary churned out $300 million in pretax profits, or 50% of the bank's total earnings. As a result of the deals, NCNB's assets have shot from $30 billion in 1988 to $66 billion.

That's just about the right pace for McColl, America's boldest banker. "I like growth, I like change, I like excitement," he says. "Once you stop growing, you start dying." A tough boss who served in the Marines in the late Fifties, McColl has a quick wit, an even quicker temper, and a long memory for slights. He sees banking as war, thrives on the fight, and hates to lose. Until a few years ago, when it started getting too much press attention, he kept a dummy hand grenade symbolically perched on his desk as a paperweight. He says: "One of my jobs is bringing chaos to order."

CHAOS pretty well describes the world of commercial banking. Inefficient banks and thrifts are failing in record numbers. Industry giants are hobbled by a decade of bad loans to real estate moguls, oil barons, and Latin American countries. Meanwhile, a handful of healthy super-regionals like NCNB are buying assets at bargain prices and challenging their bigger brethren. Not surprisingly, many of the fast growers are establishing beachheads in Texas, where assets are cheap and expansion comes quickly. The No. 3 bank in the state is owned by Banc One of Columbus, Ohio, which in the past five years has bought 46 banks, both in and out of Texas.

REPORTER ASSOCIATE *Rosalind Klein Berlin*

NCNB will be a $100 billion bank within five years, says McColl. He's putting up a grand new headquarters in Charlotte to match. Locals call it the Taj McColl.

Either by preying on fallen thrifts and banks or through mergers with other financial titans, these up-and-comers see rapid expansion as the key to prosperity. Bigger empires, these bankers argue, provide a larger deposit base and loan network that will enable them to deliver banking services the way McDonald's delivers hamburgers: inexpensively and efficiently.

As they see it, huge banks will be safe banks too. They will be so broadly diversified across the country that neither a depression in Texas nor a collapse in New York City will mortally wound them.

McColl may be banking's biggest booster of bigness. He believes that a major consolidation is under way, and that aggressive growth is the only way to survive. Says he: "What I see happening in America is what has already happened in Europe and Canada. There will be very few players." The message: Buy or be bought.

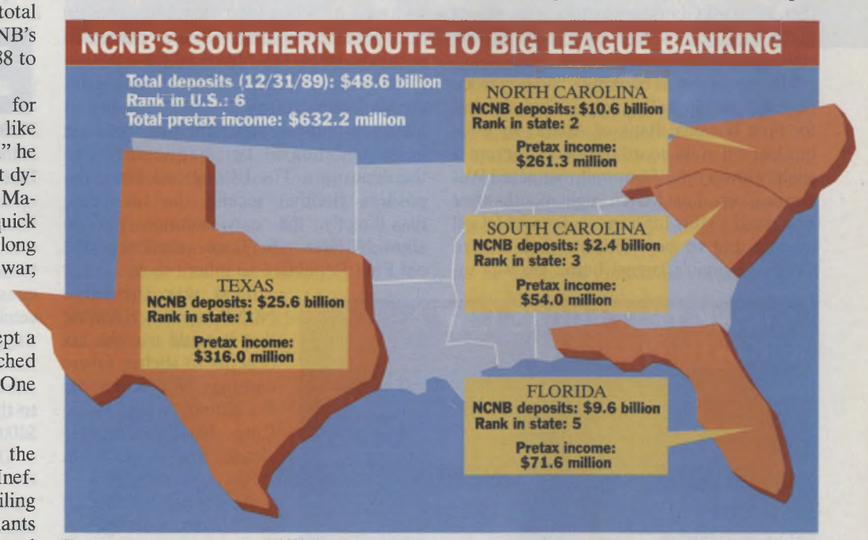
The First Republic acquisition combined with 21 other deals has given NCNB a dominant market position in four Sunbelt states (see map), where economic growth in the 1990s is likely to be far above the national average. It is the only bank outside New York and California that is among the nation's top ten, ranking sixth in deposits and seventh in assets. "We've always been big talkers," says McColl. "But reality is catching up to our rhetoric."

Still, concerns linger that NCNB and some of its peers may be reaching for too much too fast. Some past dealings of NCNB's staff do nothing to allay those fears. The strategist behind the First Republic coup, and for six years NCNB's chief financial officer, is Timothy Hartman, formerly the top financial executive at another highflying financial company, Baldwin-United, which went bust in 1983.

During Hartman's tenure at Baldwin-United, the company rose like a rocket on swelling sales of single-premium deferred annuities and the aggressive use of tax shelters. It ultimately ran into problems because it took on too much debt, and it was later charged by the Securities and Exchange Commission with overstating its earnings. Hartman temporarily stepped down from his NCNB post in 1985 to face an SEC investigation into whether he knowingly helped Baldwin-United doctor its books. He vehemently denied the charges and in 1986 settled with the SEC, accepting a court order that he not violate the securities laws.

In banking it is almost axiomatic that rapid growth brings problems, usually a rush of bad loans. That's just what happened when NCNB went on its buying spree. In the second quarter, NCNB's nonperforming assets, mostly bad loans and foreclosed real estate, doubled over last year. Even so, nonperforming assets are only 1.12% of total assets, below the industry average.

What has kept NCNB away from disaster is McColl, who, despite his go-go attitudes, knows the nuts and bolts of banking and has



First Republic helped make NCNB the only top ten banker outside New York and California.

a talent for making good loans out of bad. He grew up in a small town in South Carolina. His "Daddy" was a cotton merchant, a farmer, and also worked as the president of the local bank. An indifferent student at the University of North Carolina, McColl learned about management as an officer in the Marines. "They've got the best management training of anybody," he says. "We were always told to feed the troops first and to lead from in front." A bank in North Carolina—one of the predecessors of NCNB—where his father sent him to gain experience taught him about lending. McColl won special attention in the 1974-75 recession when he took charge of NCNB's most troubled loans and kept them from dragging the bank under.

NCNB could be growing even faster were it not for McColl's reputation as a marauder. In the early 1980s he incensed Floridians when he bought up a string of banks around the state, got rid of many of their executives, and then criticized local bankers for being lazy. His irreverent humor hasn't helped either. He riled Georgians by joking he wasn't going to go down "every pig path" in the state to build a big bank there.

His reputation as banking's bad boy twice played a part in foiling acquisitions. He bid for First National Bank of Atlanta in 1985, but lost when its board decided to accept a slightly lower offer from well-mannered Wachovia Corp. Last March, eight months after he agreed to buy his bank in Texas, McColl made a bid to buy Citizens & Southern Corp., Georgia's largest bank. He was rebuffed, after which C&S agreed to merge with Sovran Financial Corp., a Virginia bank, at a market price lower than the one offered by NCNB.

Whatever qualms bankers have about McColl, they don't expect him to get his comeuppance anytime soon. The reason: the strength of the deal in Texas. It was a most unlikely acquisition, by some measures too big a deal for McColl's bank to handle: First Republic's assets were $4 billion more than NCNB's. Says McColl: "No one took us seriously."

STEVEN HUNTER

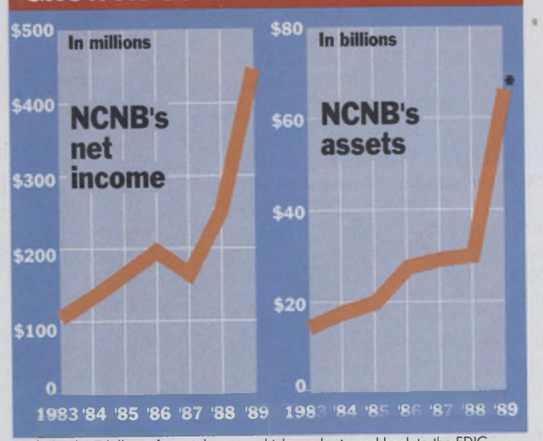
Timothy Hartman engineered NCNB's Texas buys. Now he runs them.

To overcome the size handicap, McColl looked for a way to offer the FDIC a bid it couldn't refuse. With the help of Hartman, he found it. When First Republic came up for sale, Hartman focused immediately on a critical asset—$5 billion of tax-loss carry-forwards. Normally when a bank fails, the tax losses expire with the company. But Hartman built an argument that those tax benefits should be bequeathed to the depositors. The IRS agreed. Since depositors couldn't receive the tax benefits directly, the easy solution was to allow NCNB's new Texas subsidiary—the old First Republic—to inherit them.

That was the edge NCNB needed. Knowing that it could use the tax benefits to shelter future earnings, NCNB was able to outbid Wells Fargo Corp. handily. Congress closed this loophole in 1988.

Better still for McColl and his forces, the generous purchase price he offered for Republic didn't cost his bank much at all. Faced with a rising number of failed thrifts and a shortage of qualified buyers, the FDIC settled for a commitment that NCNB would invest the bulk of the purchase price, some $1.3 billion, in its new subsidiary instead of giving it to the FDIC, in effect allowing NCNB to transfer money from one of its pockets to another. McColl still marvels at what a terrific deal he got. "Candidly, I think we paid zero for First Republic."

A BANK THAT LOOKS LIKE A GROWTH COMPANY



*Includes $4.7 billion of special assets, which can be turned back to the FDIC between Nov. 22, 1991, and Nov. 22, 1993.

Profits and assets are up fourfold in six years.

EVEN ZERO might be too much to pay for a portfolio of troubled loans. But NCNB made sure that it could shift its most risky loans back to the FDIC. It set up a special asset division to be a halfway point between the bank and the FDIC, and transferred bad loans with a face value of $10.6 billion into this division. Once loans are moved into the special asset division, they remain on NCNB's books, but the bank may put them back to the FDIC, no questions asked, at any time between November 1991 and November 1993. The bank shipped $1.2 billion of bad loans over to the division last year. It also has the right to shift another $750 million of troubled loans back to the FDIC if necessary in addition to the $10.6 billion.

The only thing the First Republic acquisition didn't provide was an extensive branch network. McColl fixed that by buying up enough banks and thrifts in the state to double the size of its Texas branch network to 252 branches. The transactions left NCNB Texas, as the amalgamation of acquisitions is called, the leading bank in four of the state's five biggest urban markets: Austin, Dallas, Fort Worth, and San Antonio.

NCNB's worst headache, short term, is a backlash of borrowers. Though the FDIC assumed ultimate responsibility for First Republic's troubled loans in the special asset division, it hired NCNB to manage all the loans, that is, to collect interest and principal payments from the borrowers. Hartman, who now heads NCNB Texas, must play the heavy to local businesses.

As a result, NCNB is suffering a wave of bad publicity. Texas business people have singled it out as the out-of-state bank that isn't giving back its fair share. They call it "No Cash for Nobody." One commercial loan that NCNB Texas foreclosed on actually led to a demonstration by factory workers outside the parent bank's Charlotte headquarters. Reflecting the bank's growing unpopularity, a flurry of "anti-NCNB" legislation has been drafted and is expected to be introduced when the Texas legislature next meets in January 1991. Says McColl: "They have to have somebody to be angry at. We are the holders in due course of that anger."

AS NCNB SEES IT, the bank has had little choice in dealing with most borrowers. "One of the first things [FDIC chairman] Bill Seidman made clear," says McColl, "is that he wanted us to take the heat on the loans in Texas." NCNB's mandate was to collect what was owed to the FDIC as fast as possible.

The collection effort has been a success. Says Hartman: "We think we'll be getting about 60 cents on the dollar." That compares with some recent thrift failures where recoveries have run closer to 30 cents on the dollar. The difference, says Hartman, is that NCNB has been working hard with the original borrowers. In exchange for getting either more cash or collateral from the original borrower, NCNB may forgive some of the debt and knock down the interest payments. As an added incentive, it also gives the borrower a chance to profit if the workout goes well. Congress may want sterner treatment of defaulted borrowers, but in the end, Hartman argues, the deals he works out are much cheaper for the FDIC than foreclosing on the loans and having to sell off the properties to new buyers.

The criticism of NCNB's loan policies, though widespread in Texas, is not fair. Like other bankers operating in troubled territory, NCNB Texas is an extremely cautious lender. But the bank is still making loans. NCNB put out some $2.2 billion of new loans in Texas in 1989, a 20% increase over 1988. That's in a state where overall loan growth has been flat (see following story). Kenneth Lewis, president of NCNB Texas Bancorp, which oversees the bank's Texas operations, would like to lend much more, but high-quality borrowers who are not already overextended are scarce.

Some analysts worry that in its eagerness to grow, NCNB will go on an injudicious lending spree. Despite the new loans, NCNB Texas is getting backed up with deposits, which continue to flow in as depositors seek the safety of an FDIC-member bank. The company has added to its investments in Treasury securities, which are safe but not as profitable as loans.

One possible solution: another deal. NCNB could tie up with a bank that is short on deposits but has plenty of demand for loans. Likely candidates include banks with big credit card operations.

Before he can make a bid to go national, McColl must first cope with the Southeast banking compact, a reciprocal regional agreement backed by legislation in 13 states, which requires that 80% of NCNB's deposits be from the Southeast. (Takeovers of failed banks, like First Republic, are exempt from the Compact's restrictions.)

But McColl doesn't worry much about those barriers. His team has a way of getting around obstacles. Besides, if not next year, then a few years down the road he figures that the restriction will tumble along with other barriers to interstate banking.

Looking ahead, McColl sees even more intriguing possibilities. "At some point we're going to be joined with a company that doesn't look like us," he says. "It might be a big generator of consumer loans or an organization with special talents like investment banking." One idea bouncing around the halls in Charlotte: a merger of NCNB, BankAmerica, and Bankers Trust. By 1995 the result could be a $280 billion behemoth with a show-stopping retail franchise and investment banking clout, a company big enough to kick some sand in the face of the giant Japanese banks.

Make no mistake: That's a Nineties banker talking. F

GARY O'BRIEN—THE CHARLOTTE OBSERVER

Health-tex defaulted on a loan from First Republic. Now workers direct their wrath against NCNB.

INVESTOR'S SNAPSHOT

NCNB

ASSETS (latest quarter)	**$66.2 BILLION**
CHANGE FROM YEAR EARLIER	UP 101.2%
NET PROFIT (latest four quarters)	**$557.2 MILLION**
CHANGE	UP 91.8%
RETURN ON COMMON STOCKHOLDERS' EQUITY	**18.3%**
FIVE-YEAR AVERAGE	14.5%
STOCK PRICE RANGE (last 12 months)	**$33.625–$55.00**
RECENT SHARE PRICE	**$36.125**
PRICE/EARNINGS MULTIPLE	**7**
TOTAL RETURN TO INVESTORS (12 months to 7/27)	**–22.4%**

BROTHER, CAN YOU SPARE A LOAN?

Not easily. It's tough to borrow money in Texas—especially if your collateral is real estate.

■ *by John Davidson*

THOUGH LONE STAR bankers insist they have plenty of cash looking for a home, loan portfolios at Texas banks have shrunk 30% in the past four years (see chart). Federal and state regulators are trying to make up for the excesses of the past by rationing credit; thus, the cost of borrowing has become exorbitant.

Says a Dallas broker of his attempts to finance an apartment complex: "All the banks say they want to lend. But for a $4 million loan, they want you to guarantee $2 million personally and put up a $2 million certificate of deposit as collateral for the rest. Then it's two to four points up front and three over prime." Because big borrowers have access to pension funds, insurance companies, and other private lenders, the hardest hit are the small businesses that were the mainstays of the savings and loans.

Two developments are contributing to this very real statewide crunch—the rising power of bank regulators and the falling value of real estate. Regulators are insisting that more loans be designated as nonperforming and written down in value. They are also setting stringent limits on how much lending may be done to one industry. Says Kenneth W. Littlefield, the Texas banking commissioner who oversees state bank regulators: "It's difficult to measure regulator pressure vs. voluntary response, but bankers are afraid of regulators."

One banker in central Texas describes bank regulators as "all powerful." Then he adds: "The granting of credit is always a judgment call. The small and medium-size lender who relied on his knowledge of and relationship with the borrower has been devastated. All that currently matters is cash flow. Lenders are paranoid anyway, having seen so many loans blow up in their faces. In the current environment, they have no incentive to take any risk."

Ponder the case of the aptly named Philip Jobe—pronounced just like the Old Testament patriarch—whose financial life became a trial of Biblical proportions when his lender, Olney Savings Association in Dallas, went under in 1988. The owner of Westwind Properties, a developer of single-family subdivisions near the booming Dallas–Fort Worth airport, Jobe had approximately $20 million outstanding in borrowings.

When Olney was taken over by AmWest Savings Association, Jobe's loans came under the supervision of the Federal Deposit Insurance Corp. As a result, he could do nothing with his property without government approval. "The red tape is a nightmare," he says. "I've got $10 million in contracts with legitimate buyers, but I can't get clearance from the feds to sell the lots. Nobody at the agencies will make a decision. No one will approve a sale."

Declining real estate prices have helped regulators put the screws to credit. Land is no longer viewed as good collateral. According to the Texas Bankers Association, real estate lending is off by about one-third, from $45.9 billion in 1986 to $30.2 billion at the end of 1989. Testifying to the House banking committee last June, Robert E. Harris, president of the Texas Bankers Association, said, "My telephone rings daily with calls from bankers across the state, reporting significant write-downs in their real estate portfolios required by bank examiners."

SOURCE: FEDERAL CALL REPORTS

OVERHANGING the real estate market like hazy, humid weather is the forced liquidation of the properties held by both the FDIC and Resolution Trust Corp.—the latter alone has in excess of 19,000 tracts in the state, valued at more than $10 billion. If these are dumped at significant discounts, the prices will be used as the basis for reappraisals of comparable properties, which could cause a downward spiral.

The banks are refusing to advance money on real estate. And borrowers in other businesses are discovering that loans secured by real estate cannot always be rolled over. Says Phil Jobe: "They say Texas hasn't been redlined, but walk into a bank, mention real estate, and see what happens. Six months ago I went to a bank where I have a long-standing relationship to apply for a non-real-estate-related, completely secured loan. The lending officer said if I weren't in the real estate business, he'd have the authority to approve that loan on the spot. If that isn't redlining, what is?" F

REPORTER ASSOCIATE *Rosalind Klein Berlin*

TIM ROOTE

The FDIC tries the patience of Jobe, who waits for clearance to sell his lots.

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BANGKOK
KATHMANDU 4 FLIGHTS A WEEK
47 FLIGHTS A WEEK CHIANG MAI
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14 FLIGHTS A WEEK TOKYO
2 FLIGHTS A WEEK NAGOYA
11 FLIGHTS A WEEK OSAKA
19 FLIGHTS A WEEK TAIPEI
45 FLIGHTS A WEEK HONG KONG
HANOI
VIENTIANE
HO CHI MINH
MANILA
BRUNEI
HAT YAI 28 FLIGHTS A WEEK
JAKARTA 7 FLIGHTS A WEEK
SINGAPORE 32 FLIGHTS A WEEK
K. LUMPUR 12 FLIGHTS A WEEK
PENANG 9 FLIGHTS A WEEK
PHUKET 51 FLIGHTS A WEEK
YANGON 3 FLIGHTS A WEEK
COLOMBO 3 FLIGHTS A WEEK
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HOW BUSH MANAGES THE PRESIDENCY

He says he's dedicated to problem solving, and he's got a big one in Kuwait. Not to mention the S&L bailout and the deficit. Is it time for a little vision?

■ *by Ann Reilly Dowd*

NOTHING tests a President like a world crisis. The one Saddam Hussein handed George Bush in early August had just about everything: blatant aggression, horrendous economic ramifications, and no easy way for the U.S. to exercise its power. To make the testing even more severe, the Iraqi tanks rolled into Kuwait just as a few other things were unraveling for the President.

Bush had wafted into his second summer on a cushion of good will. The Cold War was over. The economy was still growing, although sluggishly. Despite 13 successful vetoes, Bush's relations with Congress remained chummy. And his approval ratings topped the charts.

Then his charmed life abruptly ended. Bush broke his no-tax pledge. The price of the S&L bailout exploded to $100 billion-plus, and the President was dramatically linked to the scandal through his son Neil's directorship of a bankrupt S&L. His deficit reduction talks with Congress collapsed, and it looked as if he had given away the defining Republican issue for nothing. His approval ratings dropped sharply. When the Iraqi invasion sent oil prices soaring and the Dow plummeting, murmurs began around Washington demanding stronger action. One Washington disc jockey taunted: "Kick ass, George. Kick ass."

REPORTER ASSOCIATE *Jennifer Reese*

CAROL T. POWERS—THE WHITE HOUSE

With (from left) Boskin, Brady, Darman, and Porter: "At the top it's very small, very clubby."

Sorry, boys. In calm or crisis, manager Bush is much the same: energetic, engaged, consultative, and ever cautious. While Ronald Reagan governed with bold ideas expressed passionately and often, Bush prefers behind-the-scenes dealmaking with friends. Not only does he feel uncomfortable in the bully pulpit, he believes public sabre-rattling—whether aimed at recalcitrant Democrats in Congress or an Arab dictator running amok—is counterproductive. Instead he goes out of his way to build consensus one-on-one, behind closed doors. Yet, if Americans begin demanding bolder leadership, and Bush seems stymied in the Middle East, he could stumble on vision as Reagan did on details.

George Bush's is a high-energy, do-it-yourself presidency driven by a zest for problem solving—or as he put it in his acceptance speech at the Republican National Convention, "missions defined, missions completed." He understands the mechanics of government, and he loves to pull the levers. While he respects the bureaucracy, he often circumvents it, going out of channels for information. He dives into the nitty-gritty of policymaking. And yes, he likes to check who's playing on the White House tennis court and horseshoe pit, who's flying on Air Force One, and who's sitting next to whom at White House dinners.

Bush hates controversy, values secrecy, and delights in surprise. He is cautious but will take a calculated risk. Though he reaches out for a broad range of opinion, in the end he turns to a very few close aides, mostly in the White House, where power within the Administration has become increasingly concentrated. He delegates, but like a CEO who's held every job in the company, he sometimes can't resist penciling himself in. He insists on loyalty and team play, but make no mistake, he loves being captain of the team.

WHILE MOSTLY a plus, Bush's hands-on management style has its minuses. During the abortive coup against Panamanian strongman Manuel Noriega that preceded the successful U.S. invasion, the President's attention to detail proved paralyzing. Taking calls directly from the field, he turned the Oval Office into a military operations center replete with maps and raw intelligence data that he personally ordered from the CIA. Buried in unfiltered and often contradictory information, the President hesitated and the coup fizzled.

Since then, procedures for crisis management have emphasized more thorough staffing. The invasion itself was a model of delegation. After Bush made the basic decision, he let Defense Secretary Richard Cheney and his generals manage the operation. Between phone briefings by Cheney every 20 minutes or so, Bush called world leaders to inform them of the U.S. action.

Bush's handling of the Iraqi crisis followed the same pattern. After he learned of the attack around 9 P.M., he instructed U.N. Ambassador Thomas Pickering to call a meeting of the Security Council. While National Security Adviser Brent Scowcroft worked through the night in the White House situation room, Bush slept. Scowcroft awakened Bush at 5, and the President signed orders freezing Iraqi assets and blocking most imports, including oil. The President was in his office by 5:45, watching the news, reading reports, and talking to aides.

Though it turned out to be a very long day, it included most of what Bush had on his original calendar. He flew off to Colorado for a scheduled meeting with Britain's Margaret Thatcher, who joined Bush in strongly denouncing the invasion. In between meetings, speeches, and a press conference, Bush squeezed in detailed discussions by phone with the leaders of Egypt, Jordan, Yemen, and Saudi Arabia. Though the Pentagon got three carrier battle groups moving toward the region, the President understood that his military options were difficult at best. He worked for consensus among Arabs, whom he recognized would be key to any move against the Iraqis.

Bush did not have to phone Soviet President Mikhail Gorbachev, because Secretary James Baker was already meeting with Soviet Foreign Minister Eduard Shevardnadze in Siberia. After flying to Moscow, they made a joint statement demanding Iraqi withdrawal and an end to arms shipments to Iraq by all countries. Throughout the early hours of the crisis, Bush characteristically revealed little in public.

The President's emphasis on teamwork has its occasional downside. Says one aide: "Sometimes controversial ideas and issues get swept under the rug." Adds former Bush chief of staff Craig Fuller: "People tend to watch where Baker and [Budget Director Richard] Darman are coming down on an issue, then fall into line." Sometimes the President may put too much faith in individuals. After the Tiananmen Square massacre, Chinese leader Deng Xiaoping, who once called Bush "old friend," would not even return his phone call.

His near obsession with secrecy can backfire too. Had he talked with conservatives before breaking his no-tax pledge, Bush might have avoided an embarrassing vote in the House Republican conference against any tax increases. His misinformation campaigns have from time to time undercut his otherwise warm relationship with the press.

The presidential management style took

CAROL T. POWERS—THE WHITE HOUSE

In contrast to Ronald Reagan, Bush treats his staffers like family. But this baby really is family: the President's newest grandchild, Charles Walker Bush.

shape during Bush's struggling days as a Texas oilman. Recalls younger brother William "Bucky" Bush, who worked on his rigs as a roughneck: "He knew all his people by their first names. He studied geological charts and logs to figure out what properties to buy. Then he'd assemble rights, raise money to drill, and get a chunk of the common stock for his sweat equity." He was a risk taker, but within limits: Unlike many wildcatters, he didn't personally guarantee anything. His deals always had more upside than downside.

Most important, the young Bush placed a high priority on people and trust. "In those days deals were done on a handshake," says Bucky Bush. "On closing day you'd whip up a two-page contract, then you were off and running. The key was personal trust and knowledge of character—and boy, were there some characters in Midland in those days! If you didn't know the good ones from the bad, you were history."

Such personal skills helped George Bush boost morale at the Republican National Committee during Watergate, and at the CIA after congressional revelations of wrongdoing. At the CIA's Langley, Virginia, headquarters, he often rode the employee elevator instead of the personal one reserved for the director, and he asked that staffers call him George. (When he left a year later, he received a standing ovation in a crowded CIA auditorium.) His first day as President Nixon's Ambassador to the United Nations, he shook every employee's hand at the 12-story U.S. mission in New York. Says White House Chief of Staff John Sununu: "He is a master of the small gesture."

With the exception of four years as a Texas Congressman, Bush's management experience has always been in executive jobs where business was conducted mostly in private. Loose lips don't work for oilmen, party chairmen, diplomats, spy masters, or Vice Presidents. A member of the secret Skull and Bones Society at Yale, Bush reveled in the cloak-and-dagger privacy of the CIA: He once stunned aides by coming to a meeting in a CIA disguise—a red wig, a big nose, and thick glasses. As Vice President he steadfastly refused to tell even his closest aides what he was saying to Reagan. His Chief of Staff Admiral Dan Murphy told prospective employees: "If you leak, you will be fired." Not surprisingly, his office was known as a tight ship.

Beyond the Cabinet, Bush chose personal friends for most top White House positions as well as some judgeships, ambassadorships, and a surprising number of key agency positions. Among them: the Peace Corps, the Federal Trade Commission, the Federal Energy Regulatory Commission, and the Overseas Private Investment Corp.

DAVID VALDEZ—THE WHITE HOUSE

Flying to Kennebunkport with granddaughter Marshall Bush and dog Millie

DAVID VALDEZ—THE WHITE HOUSE

After a 6:30 A.M. breakfast in his private study, Bush pecks out notes.

AT THE WHITE HOUSE, Bush's past is prologue. Outraged by the internal warfare that characterized the Reagan Administration, Bush put a high priority on team play. While Reagan turned to a headhunter to fill most Cabinet and White House posts, Bush personally chose loyal and seasoned friends. Sitting around the pool at Camp David, First Lady Barbara Bush told Environmental Protection Agency Administrator William Reilly, the only newcomer to Bush's inner circle, "I said to George: 'You know, almost your entire Cabinet are our friends.' He said: 'Well, what would you expect?' "

To drama seekers' dismay, the bickering has stopped. It's not that Bush's team lacks ego or differences of opinion. No one has ever called Baker, Darman, or Sununu fainting flowers. But in sharp contrast to the Reagan years, Cabinet members and senior White House aides have direct and frequent access to the President. He invites strongly argued points of view and takes his time deciding. But once he's spoken, he expects his troops to fall in line. Bush told a packed Republican fund-raiser on his 66th birthday in June: "I thank my lucky stars that we can fight like cats and dogs in Cabinet meetings but once I make a decision, move on as a team." He also likes to point out: "Loyalty is not a character flaw."

Bush shares credit, often allowing his Cabinet Secretaries to announce new initiatives. He also shares blame. After his devastating defeat in the Iowa caucuses, his Iowa campaign manager Richard Bond said, "It's my fault." Replied Bush: "No, it's mine." Similarly, in policy battles the loser is rarely punished. More often he's built up. Shortly after Transportation Secretary Sam Skinner lost to Darman in a bid for more money for roads, bridges, and other items of infrastructure, Bush invited him to Kennebunkport for a weekend of golf, boating, and family fun. At 6 A.M. on Saturday, Skinner heard a knock on his cottage door. When he opened it, he found the President in his robe, carrying a tray with a pot of steaming coffee. "It's your wake-up call," said Bush.

While Reagan inspired his staff with a few big ideas articulated often and with feeling, Bush keeps his team of problem solvers on their toes with rifle-shot questions. Bred on sports and socializing, he prefers people and action to theory. He was raised in preppy Connecticut, where grand notions passionately expressed were considered freakish. While Reagan focused on a single issue of the day, Bush handles dozens at a time, often blurring his message in a whir of activity. When he talks off the cuff, sentences disappear in a tumble of words and clipped phrases. Even when he's listening, he's apt to be fiddling with something.

TYPICALLY Bush begins his day at 5:30 to strains of country music, after about 6½ hours' sleep. As he sips coffee and watches CNN, he skims the New York *Times*, the Washington *Post*, the Washington *Times*, the *Wall Street Journal*, *USA Today*—for the baseball scores—and the Houston *Chronicle*. By 6:30 he's eating a breakfast of grapefruit, coffee, and sometimes bran cereal in his private study behind the Oval Office, usually alone. Then there's an hour for reading, note writing on his electronic typewriter, and phoning unsuspecting aides before his regular national security briefing at 8:15. When Treasury Secretary Nicholas Brady caught a glimpse of Bush walking from the residence to the Oval Office for that briefing, his old friend and campaign chairman pointed to his watch in mock disapproval. Minutes later a note arrived in the Cabinet Room: "Brady, I've been at work since 7:10. I just got back from a meeting at the residence."

After his national security briefing, Bush meets with Sununu for up to an hour, working through a briefing book of "action items" that could range from a California poll to a speech draft to a legislative update. Afterward his day is scheduled minute by minute with meetings and events until 4:30 or so, when Sununu returns with the "P.M. agenda," a second notebook filled with items for the President's approval.

Even with his tight schedule, Bush often squeezes in spontaneous events—an unannounced appearance at a meeting, an impromptu news briefing, a quick lunch on the Hill—before leaving the office around 6:45. Says Deputy Chief of Staff Andy Card, a former Reagan aide: "Reagan was comfortable with structured events. Bush invites spontaneity. He manages by walking around."

Most evenings the President has either a formal event or dinner with friends. It's not unusual for him to phone Cabinet members, staffers, or old friends on the spur of the moment to "come over for a beer and a movie." Or he may go out to one of his favorite local restaurants. He never dines with four if he can find 40, and he loves house guests. Says one aide: "In the past the White House family quarters were as accessible as the Dalai Lama's palace. But with Bush, it seems the mattress in the Lincoln Bedroom is never cold." He also may fit in some exercise—maybe tennis, horseshoes, racquetball at the House gym, jogging at Fort McNair, or a fast game of golf. (He rushes through the course, rarely finishes, and never reveals his score.)

Still, Bush manages most nights to spend some time in his study on the second floor of the White House, where he writes more notes, reads up to 30 briefing papers, and signs decision memos. Friends say he does not agonize over choices. When he needs a break, he might fiddle with a favorite fishing rod or box of lures he keeps in the closet. As he told his brother Bucky: "I like to play with them. I put the orange ones with the orange ones. The green with the green. I check the lines. And I think about fishing off Islamorada," the area in the Florida Keys where Bush has fished for 20 years.

Says Bucky: "He relaxes with friends, family, and exercise. It's part of his ecosystem. It's the way we grew up. There were always games." When the Trinity River flooded in Texas last May, Bush choppered into the area and tromped around in the steamy heat. Then he flew on to Houston, landing at the Deerwood Country Club, where pro golfer Doug Sanders, an old friend, was playing host at a charity golf tournament. Bush played 18 holes on foot—relishing every minute, save a few short putts. Said a weary cameraman at the sixth hole: "Hey, this is nothing. A few weeks ago he played 18 holes, three sets of tennis, and then went jogging. He never stops." One staffer calls such marathons "weekends from hell."

Bush's warmth, energy, and accessibility have saved him from the isolation that plagues the presidency. While Reagan was Olympian with staff, Bush treats them like family. By now most have been invited to some homey event at the residence, Camp David, or Kennebunkport. Many have jogged, fished, motorboated, or played tennis, walleyball, golf, or horseshoes with the boss. Most feel they get a fair hearing. At his first Cabinet meeting, he encouraged calls and memos. When he gets them, he promptly responds by phone, note, or comments scribbled in the margin. When Sununu asked Cabinet members to keep him informed of such communications, Bush cut in: "When you think of it." Nor has Sununu been a bottleneck. Says EPA Administrator

Even sorting lures relaxes Bush, as does real fishing in Wyoming.

SUSAN BIDDLE—THE WHITE HOUSE

Reilly, "During the Reagan years EPA administrators had problems getting access not just to the President but to Don Regan, the Chief of Staff. Such a thing is unthinkable in the Bush White House."

In general Bush prefers getting information from people rather than from memos. So did Reagan. But while Reagan was usually a passive participant, Bush is an active questioner. In preparation for Reagan's Soviet summits, the CIA produced movies and staged lectures. Bush's presummit briefings, by contrast, were interactive events involving heads of state and experts in and out of government. Before meeting Soviet President Mikhail Gorbachev at the Malta Summit last year, Bush got in touch with Prince Sadruddin Aga Khan, a U.N. official involved in aid to

MICHAEL SARGENT—THE WHITE HOUSE

Bush often shines when jousting with reporters.

Afghanistan whom Bush had known since his own U.N. days. Bush invited his old friend to Camp David for a discussion of how Afghan factions were faring after the Soviet pullout. Before this year's summit he spoke with West German Chancellor Helmut Kohl, French President François Mitterrand, and British Prime Minister Margaret Thatcher, as well as several well-known Soviet experts.

In such meetings Bush is moved by information, not ideology. Says Brady: "He believes if you do the pick-and-shovel work, the solution will jump out. He likes a discussion framed by facts." If he can't get the answers he wants, he'll pick up the phone and call experts four and five levels down in the bureaucracy. Nor does he suffer unprepared pleaders gladly. When one Congressman questioned Bush's timid response to the Soviet embargo of Lithuania, the President shot back: "What do you have in mind? What should I say when Soviet tanks roll in? We'll be right there? We couldn't protect the Lithuanians under any circumstances. They're not even in our orbit." Or as he often asks recalcitrant aides: "If you're so smart, why weren't you elected President?"

Bush's independent style was evident in his nomination of Federal Appeals Court Judge David Souter of New Hampshire for the Supreme Court. With his top aides divided, the President retired to his small study behind the Oval Office, where, as is his habit, he jotted down on a legal pad in order of importance short phrases outlining the pros and cons of each candidate. He decided on Souter, a solid conservative jurist without a paper trail on controversial issues like abortion, then called his staff to tell them.

IN FOREIGN POLICY Bush often circumvents the bureaucracy. When a lengthy government-wide foreign policy review failed to produce the bold arms control plan he wanted for his first NATO summit, Bush turned to Baker, Sununu, Cheney, National Security Adviser Brent Scowcroft, and William Crowe, then chairman of the Joint Chiefs, to come up with an alternative. Scowcroft proposed deep cuts in U.S. and Soviet manpower and planes in Europe. Bush liked the idea but wanted it studied more thoroughly by his military advisers. Days later Crowe told Bush the Pentagon could live with a 20% cut in manpower and a 15% cut in aircraft. Baker argued for a more dramatic 25% reduction. After checking with Cheney, Bush settled on 20%. "OK, that's consensus," said the President. "Let's go."

He generally feels more confident on foreign than domestic policy issues. Aides say Bush phones four or five heads of state a week for a total that exceeds that of the last six Presidents combined. It's a habit that helped mightily in the Iraqi crisis. His wooing of Gorbachev, Kohl, and Mitterrand also paid dividends in European affairs. Says former U.S. diplomat Robert Hormats, now vice chairman of Goldman Sachs International, who recently dined with Kohl: "Bush's personal diplomacy enabled him to discuss a new European security arrangement with Gorbachev in Washington without the Germans feeling he was going behind their backs. It's all about trust."

In the domestic arena Bush is more likely to rely on the bureaucracy as a way of sorting out different points of view. But even then he often pulls the management of policymaking into the White House. The Administration's education, crime, child care, and clean air proposals were developed in small meetings with Cabinet members around an antique table in the West Wing office of Roger Porter, the President's domestic policy chief.

To whatever is done by staff, Bush adds his own layer of personal intelligence gathering for what national security types call "sanity checks." After the Senate sustained his 11th veto (Amtrak) and before it took up his 12th (the Hatch Act revision), the President slipped up to the Hill for a friendly, pulse-taking lunch with Senate Minority Leader Bob Dole, who was his GOP primary rival but is now a staunch ally, and longtime friend and hunting buddy Alan Simpson, the Wyoming Senator who is minority whip. A quick visit to the kitchen staff topped off the lunch.

Before deciding to convene a budget summit, the President met separately in the family quarters with Dole, Senate Majority Leader George Mitchell, House Speaker Thomas Foley, and Minority Leader Robert Michel. Says Porter, who taught Harvard's course on the presidency before joining the Bush Administration: "Every President does some of this. But Bush does a great deal more."

WHILE the President casts his net wide for information, he turns to a few key aides when it's time to decide. Says one aide: "At the top it's very small, very clubby. There's lots of camaraderie, humor, and male bonding. That's how the boys defuse tension and avoid burnout." The President's inner circle is filled with heavyweights, though of surprisingly different temperaments. There are three hard-nosed competitors—Baker, Sununu, and Darman—and two soft-spoken ones—Brady and Scowcroft. A step removed from the inner sanctum are two brainy but mild-mannered professors: Porter, the domestic policy chief, and Michael Boskin, chairman of the Council of Economic Advisers. Chief White House counsel Boyden Gray, an old Bush friend and tennis partner, is also a trusted adviser.

Bush is clever about using different personalities for different tasks. Sununu, the brusque but brainy engineer and former New Hampshire governor, plays bad cop to Bush's good cop. When Democratic Senator Daniel Patrick Moynihan proposed cutting Social Security payroll taxes, some conservatives appeared to be circling favorably around the idea. The White House thought for a while that the U.S. Chamber of Commerce might back Moynihan. Sununu reportedly phoned Chamber President Richard Lesher and threatened to "cut your b---- off with a chainsaw." The Chamber did not lobby for the proposal, which went nowhere.

DAVID VALDEZ—THE WHITE HOUSE

An ecosystem of support: first partners at dusk at Kennebunkport

Darman, who has built a powerful alliance with Sununu, is the President's chief economic strategist. Baker drives foreign policy. Scowcroft and Brady are trusted counselors who mainly stick to their respective areas of expertise—defense and finance. But the President knows neither has ambitions beyond making the Bush presidency work, so they are often the last guys in the room before the President decides.

Still, Bush has no single guru. He enhances his personal power by sharing information only on a "need to know" basis. When Bush sent Scowcroft and Deputy Secretary of State Lawrence Eagleburger on a secret mission to China after the Tiananmen Square massacre, he didn't tell Sununu. When he met with congressional leaders before calling a budget summit, he didn't tell his own congressional aides what he was going to talk about. Though the President drops FYIs to aides, his White House staff has long ago stopped trying to keep track of all his private conversations. Says one aide: "If the President is making the decisions, the only important thing is that *he* keeps track."

At times it seems no decision is too small or innocuous for Bush. During the development of his 1991 budget, he made about 70 relatively micro decisions, most of which would have been settled by staff in the Reagan years. He's often his own foreign desk officer, political strategist, even his own office manager. When Bush discovered that his correspondence unit was 70,000 letters behind, he trotted down to the letter-writing shop to see what the problem was. The pace quickened and the backlog is down to a few thousand.

ON MORE substantive issues his peripatetic presence makes for a very personal and unpredictable pattern of decisions. When there is controversy, Bush typically splits the difference. When the steel quotas were about to expire last year, Labor Secretary Elizabeth Dole argued for a five-year extension. Commerce Secretary Robert Mosbacher and U.S. Trade Representative Carla Hills pushed for four with a reassessment after two. Boskin wanted only one, limited to certain product lines. The President asked Porter to propose an alternative. The final compromise was a 2½-year extension for all product lines.

When there is consensus, Bush usually goes with it—but not always. After the Tiananmen Square massacre he bucked his staff and vetoed a popular bill allowing Chinese students to remain in the U.S. Even when he goes with the broad consensus, he often fiddles with the final details at the last minute. He picked the exact dollar-and-cents increase for his minimum wage and federal employee raise proposals. After three discussions with Porter over what constitutes an assault rifle, he decided to propose a ban on all automatic weapons with magazines that hold more than 15 rounds.

Accessibility and unpredictability are clever strategies for keeping the opposition off guard. In only 18 months Bush held 57 press conferences, more than Reagan did in eight years, and many on less than an hour's notice. "How's the temperature out there?" Bush often asks Press Secretary Marlin Fitzwater. If it's rising, Fitzwater quickly briefs Bush on likely questions. Then he's off to meet reporters. Though wooden in formal speeches, Bush's grasp of detail and zest for competition let him shine when jousting with the press, despite his occasional woolly syntax. Fitzwater has never had to issue a correction, a frequent occurrence with Reagan. Congress has also found it difficult to categorize this President. While Reagan took bold stands but then compromised, Bush focuses quickly on what's possible. Faced with hopeless odds, as in aid to the Nicaraguan contras, he caves artfully and proclaims victory. When he agrees with Congress on the objective—such as the Clean Air Act—he works closely with the opposition. When he thinks he can win, as in the case of his successful vetoes, he doesn't budge. Says Brookings Institution scholar Thomas Mann: "He's a very adept tactician."

But what about a strategic plan? When reporters bring up the "vision thing," Bush's stock answer is: "Don't put me on the couch. Don't analyze me." Insiders say dealmaker Bush doesn't want to invite criticism or limit his options by defining goals. Outsiders wonder whether he knows what he wants. Brother Bucky's explanation is pure Bush pragmatism: "I think George would agree with investor Warren Buffett, who says that long-range planning has extreme limitations, especially when it comes to macroeconomic policy. What really counts are the day-to-day things. If you do well in the short run, the long run will take care of itself." So far in this Administration, vision is what works today. F

WHAT'S AT STAKE IN THE TRADE TALKS

Negotiations now nearing their climax could open up world commerce as never before. An agreement would benefit thousands of companies and millions of consumers. ■ *by Lee Smith*

THEY ARE MOSTLY gray-suited and sober-faced bureaucrats, but they understand magic: If each nation is free to concentrate on doing what it does best, the world will get richer. With that wizardry in mind, negotiators from around the globe are waging the perilous final battles of a four-year campaign to create the most complex, liberating, and beneficial international trade pact ever.

The stakes are high. Similar negotiations in the Sixties and Seventies under the General Agreement on Tariffs and Trade lowered barriers on manufactured goods and helped world trade triple over the past two decades. The current Uruguay Round (the first meeting was held in Punta del Este) has a new goal: to abolish many of the barriers that have survived—the biggest, oldest, toughest trade barriers on earth. Success would open up international commerce as never before and create opportunities for thousands of companies in the fastest-growing parts of the economy: service industries and those areas involving copyrights and trademarks. U.S. Trade Representative Carla Hills says, "We have the opportunity to start a world economic renaissance."

The European Community could kill any deal if it doesn't drop subsidies to farmers like this Bavarian.

PHOTOGRAPH BY ROBERT NICKELSBERG—GAMMA-LIAISON

Can the negotiators do it? They can, although their chances of finishing an agreement by December, when the world's trade ministers are to gather in Brussels to sign it, look moderately grim. Remember, all those barriers protect somebody somewhere, probably groups with impressive political clout, which is what got the barriers enacted in the first place. President Bush supports freer trade, but many in Congress, which must approve any agreement, lean toward protectionism.

The negotiations are complex. Hundreds of delegates from the 97 member nations meet intermittently, often at GATT's four-story headquarters on the shores of Lake Geneva, and divide into 15 committees that debate major issues and minutiae. But the big picture is fairly simple. The developing nations have two principal demands: fair markets for their exports of agricultural goods and for exports of textiles and apparel. The developed nations have two as well: freedom for service industries to operate anywhere and respect for intellectual property. Here's a battlefield guide.

■ **AGRICULTURE.** If you trace the contentiousness and turmoil of the Uruguay Round back as near to their source as you can, you end up in the wheat fields of Bavaria. Nearly all industrial nations subsidize farmers, but the most lavishly protected tillers of the soil are European, and the protectionism reaches the apex of absurdity in southern Germany.

The European Community not only guarantees its farmers' home markets but also underwrites their exports with a $10-billion-a-year slush fund. The system works thus: If the world price of wheat is $100 a ton, say, a grower can sell his crop to a foreign buyer at that price and collect an additional $100 or so a ton from the EC. With incentives like that, it is no wonder that Europe has more than ten million farmers (vs. 2.5 million in the U.S.). In Bavaria, where the land is especially poor for farming and other livelihoods are available, factory hands earn a second income by pouring fertilizer and pesticides on scrubby pastures to turn them into wheat fields. In a decade the Continent has been transformed from grain buyer to another breadbasket the world doesn't need.

That infuriates countries like Argentina, Brazil, Canada, Australia, and Thailand, where land and labor forces are more naturally suited to big-time farming. They and others are likely to walk out of GATT—and stop the Uruguay Round cold—unless the EC agrees to cut the subsidies way back.

The key is persuading Germans to drop their plows. For Helmut Kohl that will be a difficult sales job, one he would rather not undertake while campaigning to become the first Chancellor of a reunited Germany.

■ **TEXTILES AND APPAREL.** Now shift from Bavaria to South Carolina. The U.S. is the major obstruction to free trade in fabrics. Although the American textile industry has mechanized in recent years and can sell denim, carpets, and yarns in many markets without government help, it still demands the protection of tariffs and quotas.

Aligned with the apparel industry, labor intensive and no match for the garment makers of low-wage countries, the textile industry is a formidable power. Textiles' 900,000 workers and apparel's 1.1 million make up 10% of America's manufacturing work force, enough to demand Congress's attention.

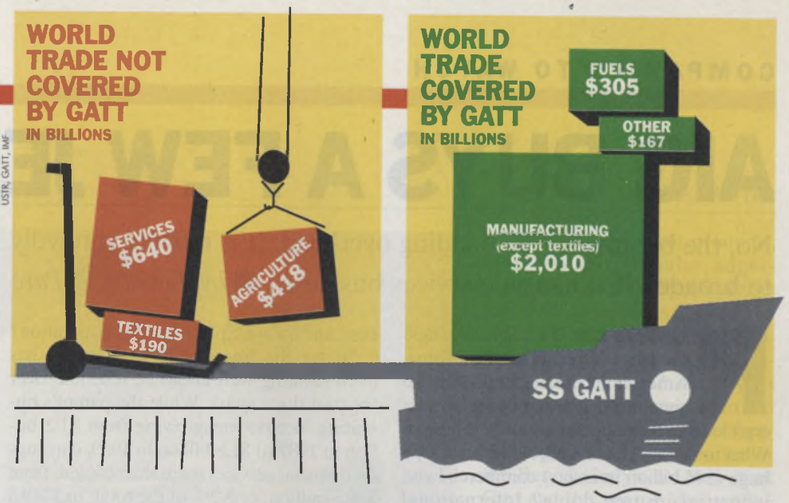
The result is an intricate weave of tariffs and quotas. A typical arrangement limits the number of man-made-fiber sweaters that can enter the U.S. from Taiwan (to 48 million) and puts a tariff (34.2%) on those that do. Taipei auctions off the quota to its manufacturers. Adding together all such auction prices and tariffs, William Cline, a senior fellow at the Institute for International Economics in Washington, calculates that protectionism adds 50% to wholesale clothing costs.

The burden could get heavier than a lead vest. Imports are growing about 7% a year, but the Senate recently passed a bill that would restrict the annual increase to 1%. Cline figures that the additional cost to consumers over ten years would be $220 billion, an amount that invites a staggering analogy. Says he: "It's comparable to the S&L bailout." President Bush promises to veto the legislation.

His Administration proposes instead a substantial reduction of tariffs and quotas by the year 2000. Cline estimates that could eliminate more than 100,000 American jobs. The loss should not be troubling for an economy that faces labor shortages, especially if the U.S. gets growth-inducing concessions from the rest of the world for its service industries.

■ **SERVICES.** The industrialized nations, particularly the U.S., want their banks, insurance companies, construction firms, and other service providers to be allowed to move people, capital, and technology around the globe unimpeded. Instead they face a bewildering complex of national regulations, most of them designed to guarantee jobs for local competitors. A new Turkish law, for example, forbids international accounting firms to bring in outside capital to set up offices and requires them to use the names of the local partners, rather than the prestigious international ones, in their marketing. To audit the books of a multinational company's branch in Buenos Aires, an accountant must have the equivalent of a high school education in Argentinian geography and history.

India is perhaps the most parochial big economy in the world these days, in many important respects more difficult to enter than the Soviet Union or China. New Delhi prevents international insurance companies from selling property and casualty policies to the country's swelling business community or life insurance to its huge middle class.



IMPORTANT CARGO STILL ISN'T ON THE FREE-TRADE SHIP

Developed nations spend $265 billion a year subsidizing agriculture; the U.S. protects textile makers; developing nations shield service providers. The latest talks aim to remove these obstinate barriers.

■ **INTELLECTUAL PROPERTY.** Many countries have weak laws or none at all protecting creativity. The big offenders: Brazil, Egypt, India, Korea, Malaysia, Nigeria, China, the Philippines, Saudi Arabia, and Taiwan. There and elsewhere counterfeiters and other rip-off artists freely imitate patented drugs, chemicals, and other industrial products, and copy goods from computer software to movies and records.

Example: Pfizer needs an average of $230 million and ten years to develop a drug, but a journeyman chemist can crush a new pill and figure out what's in it with surprising ease. In Argentina, Pfizer's antiarthritic Feldene faces 24 local competitors—none of which pay royalties. U.S. companies are estimated to lose more than $30 billion a year through theft of all kinds of intellectual property.

WHAT IF the Uruguay Round fails? Without the virtual worldwide free trade that would result, gravitational forces already in play would be more likely to pull many nations into one of three orbits with internal free trade: the EC expanded to include Eastern Europe; North America with perhaps some of Central America; and a Pacific group centered on Japan. That would not mean disaster, notes Georgetown University economist Gary Hufbauer: "If they don't put up additional barriers against outsiders but just liberalize within, trade areas are better than nothing."

But it would mean a momentous lost opportunity. GATT rounds come along no more than once a decade, so most likely it won't be until the next century that the magicians gather again. F

REPORTER ASSOCIATE *Susan Caminiti*

AIG BUYS A FEW JETS

No, the big insurer isn't adding overhead. It is moving shrewdly to broaden its financial services business. ■ *by Terence P. Paré*

RACK UP ANOTHER solid single for Hank Greenberg. Last June, American International Group announced it was buying an aircraft leasing company for about $1.3 billion. What in the world was AIG, New York City's huge ($46 billion in assets) commercial and industrial insurer, doing? International Lease Finance Corp., a Beverly Hills outfit, had earnings of $61 million last year on revenues of $334 million, mere mad money on Rodeo Drive. A quick answer is provided by Maurice R. Greenberg, AIG's tough-guy chairman (who is better known as "Hank" for the 1930s and 1940s baseball Hall-of-Famer): "We think it's a damn good investment and a very good company."

International Lease Finance is the last piece of a financial services division that AIG has been assembling since 1987. Because property-casualty insurance, the company's primary business, is inherently subject to nauseating profit swings, Greenberg wants a sizable financial services operation in place to soften the effects of the down cycle. After some initial gulping, security analysts who follow AIG—long a Wall Street favorite among insurance stocks—are coming around to Greenberg's thinking on aircraft leasing and affirming their "buy" recommendations. Concludes D. Gordon Luce of Brown Brothers Harriman: "It's a good deal."

But doubt lingers. "Portfolio managers are uncomfortable when an insurance company goes into different businesses," says Luce. As a result, the price of AIG's stock is down 13% since January, and roughly 5% since the acquisition was announced, to $74 a share recently.

AIG expects International Lease Finance and the other financial services operations to produce 15% of total operating income over the next several years. But how will an aircraft lessor fit with the other pieces of the financial services unit, including a small private Swiss bank, a swaps business, and a municipal investment operation?

So far the financial services group has been running well ahead of schedule over the past three years. While the parent's operating income was growing from $1.2 billion in 1987 to $1.8 billion in 1989, earnings on financial services more than tripled, from $39.5 million, or 3.2% of the total, to $149.8 million, or 8.5%, over the same period—a spectacular performance but still a long way from AIG's goal.

A tidy piece of those earnings on financial services comes from what can only be described as a sure thing, guaranteed investment contracts, so-called GICs, that are sold to municipalities wishing to invest the proceeds from bond issues until the money is actually required. Tax law greatly restricts the interest a state or local authority can earn on such idle cash, limiting it in many cases to the tax-free rate of interest paid to the bondholders. But there are no restrictions on what the providers of the investment contract, like AIG, can make. Right now municipal bond rates are running at 7.15%, while high-grade corporate bonds, an investment commonly bought by GIC providers, are paying 7.95%. Says Edward E. Matthews, an AIG vice chairman and the man in charge of financial services: "It's a good business." And growing. AIG has about $4.5 billion of GICs on its books, more than five times the $825 million of contracts it had written in 1987.

PETER GREGOIRE

For Greenberg, leasing the planes will cushion the air pockets.

But most of the growth in financial services—and about 80% of its income, say analysts—flows from the unit's complex trading activities like currency swaps. These are transactions that exchange obligations denominated in different currencies, enabling borrowers and lenders outside their home markets to make or receive payments in the coin of their choice. Traders earn a spread on such exchanges. Extremely volatile, the profits of a swap operation depend on the volume of transactions in the market, which traders can worry about but not control. Swap activity at AIG slowed in the wake of uncertainty about interest rates in the first half of 1990. So down went operating income for financial services from $79.3 million in 1989's first two quarters to $56.8 million in the first half of this year.

The International Lease Finance deal should help smooth the roller coaster in financial services. With about three-quarters of its business coming from foreign customers, the company can use the swaps service of its parent's trading desk. It should also be able to borrow more cheaply than in the past, thanks to the umbrella effect of AIG's triple-A rating, even though AIG will not guarantee its debt. Best of all, the leasing company has locked in prices on 258 aircraft that it is committed to buy over the next ten years. Already clients have leased or signed letters of intent on 106 of those planes. That should help reduce the number of surprises in the income statement. F

REPORTER ASSOCIATE *Jessica Skelly von Brachel*

DREYER'S GRAND ICE CREAM

BY RET AUTRY

About the only bottoms ice cream doesn't fatten are the bottom lines of the companies that make it. Net profit margins in this crowded industry are typically a svelte 5% or so. The most reliable way to plump up earnings is to expand the company. That's just what Dreyer's, an ice-cream maker that started as an Oakland sweetshop in 1928, is doing. When restaurateurs Gary Rogers and William F. Cronk III bought the company in 1977, sales totaled just $6 million and profits were but a spoonful. Today the company is one of the industry's biggest players in the premium ice-cream market. Its Dreyer's Grand brand is the best-selling premium ice cream west of the Rockies. Revenues last year rose 20% to $227 million, net operating income increased 25% to $8.5 million, and return on shareholders' equity was a sumptuous 25%.

GERRY GREGOIRE - SIPA

The sweet taste of success: Dreyer's Grand undergoes a quality check.

Chairman Rogers and President Cronk are now pursuing a sundae-size ambition of broadening Dreyer's national reach. It is the only major ice-cream manufacturer to have its own distribution system. Over a quarter of its revenues come from selling other companies' ice-cream products, most notably popular super-premium names like Ben & Jerry's and novelties such as Dove Bars. Rogers is strengthening his distribution network through acquisitions and using it to push Dreyer's own brands into grocers' frozen dessert cases. In 1989 the company bought the exclusive distributor for Ben & Jerry's in New York City, and this year it acquired the Chicago Dove Bar franchise. The popularity of the other higher-priced treats Dreyer's distributes gives the company's sales reps an added edge in persuading retailers to stock Dreyer's own less expensive brands. Over half the accounts of the company's new distributor in New York City, for example, carry Dreyer's-made products, which include a low-fat ice cream and a frozen yogurt, items introduced in the past three years. Barbara Dirvin, a security analyst at the William Blair & Co. brokerage in Chicago, estimates sales and profits will grow 36% and 29%, respectively, this year. Since January, Dreyer's shares, which trade over the counter, have risen a yummy 50%, to $42 recently, and Dirvin rates them a buy for long-term investors.

SUPERIOR TELETEC

■ Failing in one industry? Why not try another? That's what an Atlanta construction company named Bycom did in metamorphosing into Superior TeleTec, a manufacturer of telephone cables. Having lost $14 million and seen its stock wither from $10 to under $2 a share in 1984, Bycom hired James Kanely as its transforming CEO. He began by buying his former employer Superior Cable, a Texas manufacturer that supplies copper wire and cable to telephone companies. To get into the rapidly growing long-distance market, Kanely started a fiber-optic-cable division called Superior Optics. It recently developed a cable that can span 3,000 feet, six times longer than competing versions. In 1989, Kanely bought a company that makes transmission test equipment to complete the makeover. Sales last year jumped 28% to $138 million, and earnings rebounded 90% to $5 million. The stock traded recently at $7.88, only ten times earnings projected by William Oliver, an analyst at Equitable Securities. He calls the company "an undiscovered gem."

LILLIAN VERNON

■ If you haven't already received one of Vernon's mail-order catalogues, you probably will soon. It plans to send out 140 million of them this year. This eponymously named shop-by-mail company was started by a homemaker in 1951. Today it offers popular homewares such as plastic picture frames and inflatable backyard pools, over half of which sell for less than $15. Last year, budget-minded shoppers bought $155 million of merchandise. Profits surged 33% to $11 million, giving the company a 19% return on equity. The Mount Vernon, New York, outfit is expanding its offerings through two new catalogues. One, called *Lillian Vernon at Home*, offers more upscale home furnishings like hand-painted vases that average $50 an item. And for working moms who don't have time to take the children shopping, *Lilly's Kids* will arrive in mailboxes this fall. The company's stock sold recently at $23.25 a share, 11.6 times 1991 earnings estimated by Kenneth Gassman Jr., an analyst at Wheat First Securities in Richmond.

XILINX

■ You may have never heard of "gate arrays," but manufacturing them has become an estimated $2.4 billion business that is growing at 20% a year because today's computers can't do much without them. The customized chips sequence the logic that tells sophisticated electronic gear in what order its functions are to be carried out. Trouble is, if the gate array's program has a glitch or needs an update, the chips must be shipped back to their manufacturer for alterations. The delay can idle a specialized computer, such as those used in the aerospace industry, for as long as 18 weeks. But a field-programmable gate array (FPGA) developed by Xilinx cuts downtime to as little as a week. Using Xilinx chips and its supporting software, a customer can program changes at his or her own terminal. The San Jose, California, company holds 16 patents on its inventions and makes about 80% of the FPGAs sold. Analyst Michael Gumport of Shearson Lehman Brothers expects Xilinx revenues to rise 76% this year to $88 million and profits to jump 79% to $15 million. F

THE ARMS MAKERS' NEXT BATTLE

Still facing budget cuts and foreign competition, U.S. defense contractors are learning to fight enemies they should have taken on years ago: mismanagement and waste. ■ *by Nancy J. Perry*

THE LONG-TERM future is dark for defense contractors—but don't expect the big guns to admit it. "We're one of the strongest companies in terms of programs with high national priority," says Lockheed Chairman Daniel M. Tellep. "Because of the programs we're in and not in, we have a particularly good chance," says Grumman Chairman Renso L. Caporali. "General Dynamics has positioned itself in the heartland programs of all three services," says Chairman Stanley C. Pace.

The latest crisis in the Middle East is the only bracing news these guys have had in months. Within 48 hours after Iraq invaded Kuwait, defense stocks had risen 5%, and Congress was reconsidering previous plans to cut the military budget. Certainly the U.S. will need strong, mobile defenses to fend off the dangers of a post–Cold War world. But most of the cuts will still be made.

And with too many companies chasing too few programs, somebody will have to go. That somebody, the contractors say, is somebody else. Observes Under Secretary of Defense John Betti: "They are going through the first stages of competition shock. It's like the five stages of death. The first is disbelief."

Shrinking worldwide defense budgets, increased competition abroad, tougher government procurement policies, and the unnerving loss of a well-defined superpower enemy are rocking the defense industry like a barrage of multiwarhead missiles. To survive, contractors are learning to drop a few bombs of their own: laying off thousands of employees, closing underutilized plants, refusing to bid on unprofitable contracts, and becoming pickier about their own suppliers.

In the battle for market share that is heating up around the globe, the most efficient, highest-quality defense contractors will have the edge. The days of "bidding bellybuttons"—inflating job costs to cover the number of employees on the payroll—are over. Says John D. Rittenhouse, senior vice president of GE Aerospace: "In the future companies that focus on cost and performance will be around. Those that don't, won't. The basic principles of free enterprise are at work, and there's nothing wrong with that."

Farsighted companies are getting in fighting form now—before the big weapons chill sets in. In Defense Secretary Richard Cheney's fiscal 1991 budget request, money for procurement, research, development, testing, and evaluation—the part of the defense budget that most directly affects the industry—is down 6% in real terms, to $116 billion. On the day after the invasion of Kuwait, President Bush reaffirmed the Pentagon's proposal to cut the armed forces by 25% over five years.

The impact of these reductions will not be felt immediately. Contractors are still living off a $257 billion backlog of orders for which money has already been appropriated. Also, Washington being Washington, it is far from clear which weapons systems will be canceled. In his fiscal 1990 budget request, Cheney eliminated funding for 12 Grumman F-14D Navy fighters. Congress not only restored them but added another six, with the proviso that the program be terminated in 1991. Such wrangling—which stands to increase as a result of the Middle East crisis—gives companies time to regroup.

MARK RICHARDS—SIPA

For some military airplane makers the future rides on the Advanced Tactical Fighter. Above: Northrop's version.

McDonnell's Long Beach, California, factory can make 29 C-17s a year. Total order so far: six.

Or rather it gives them *more* time. Defense executives have long been aware that the business is nosing downward. Since 1985, the peak year of the Reagan buildup, budget authorization for procurement, research, testing, development, and evaluation has dropped on average 4.5% a year in real terms. Over the next few years production will slow down or stop on major weapons programs such as General Dynamics' M-1 tank and F-16 fighter plane, McDonnell Douglas's F-15 fighter, Grumman's F-14D fighter and A-6 attack bomber, and Lockheed's F-117 Stealth fighter.

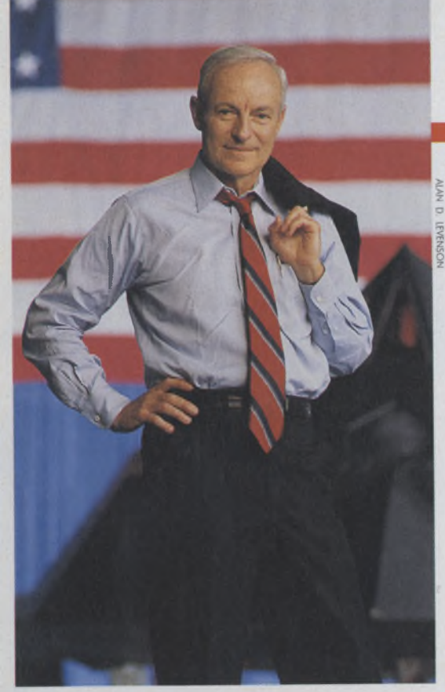
Despite the early warning, most weapons makers have not spent recent years transforming themselves into lean, mean fighting machines. Instead, they've been on the defensive, squabbling with Uncle Sam about a series of tax and procurement reforms that they say have hurt worse than budget cuts. The most onerous was the initiation in the early 1980s of so-called fixed-price development contracts. Unlike the lucrative cost-plus contracts of the past, these pay a set price regardless of how high expenses rise. In efforts to tap the Pentagon's dwindling reservoir of new, big-ticket weapons programs, contractors grossly underestimated the cost of development, bid low—and soon had billions of dollars of write-offs to show for it.

They also wound up with something else: a huge residue of debt. Bear Stearns reports that from 1986 to 1989 industrywide interest expense doubled to $1.7 billion annually. Part of that reflects heavy investments in plant and equipment during the Reagan years. But the Defense Department admits it is partly to blame. Says Betti: "The government has made inappropriate use of fixed-price development contracts by putting the risk on the supplier." The Pentagon will go back to the cost-plus model on some of its new contracts.

DEFENSE COMPANIES are now on the offensive in a war they should have been fighting all along—the campaign against mismanagement, shoddiness, and waste. "We need to do better," says McDonnell Douglas Chairman John McDonnell. Observes Rob-

REPORTER ASSOCIATES *Shelley Neumeier and Charlotte Faltermayer*

CRAIG HOLENHOUSE



ALAN D. LEVENSON

Lockheed's Tellep wants to operate airports.

ert Paulson, head of McKinsey & Co.'s worldwide defense practice: "There are proactive steps that companies can take to be players in the year 2000." Here's how weapons makers are girding for the new era:

■ **PICKING PRIORITY PROGRAMS.** This is easier said than done, for two reasons. One, there is no longer a consensus on who, or how dangerous, the enemy is. The defense industry, for all its radarscopes, is embarrassingly short on vision. Two, even if companies could figure out what to make, General Dynamics couldn't simply turn its M-1 tank factory into an assembly line for target drones. Says Boeing Chairman Frank Shrontz: "All companies are victims of where they happen to be at this point in time."

Northrop's Kresa is banking on the B-2 bomber.

NORMAN D. LEVENSON

The future of the biggest prime contractors and their suppliers depends largely on the fate of four major new procurement programs—together valued at more than $200 billion—that are under congressional scrutiny. They are Northrop's B-2 Stealth bomber, the McDonnell Douglas C-17 military transport plane, the McDonnell Douglas–General Dynamics A-12 attack bomber, and the Advanced Tactical Fighter, for which contractors have yet to be chosen. Industry experts predict that at least one prime contractor will leave the overcrowded military airframe business by the end of the decade—probably Grumman, Northrop, or Lockheed.

Which company pushes the eject button could depend largely on the race for the Advanced Tactical Fighter contract, which could be worth more than $55 billion over the next 20 years. Two teams are competing: Northrop and McDonnell Douglas vs. Lockheed, Boeing, and General Dynamics. The winning design will be chosen in a fly-off pitting prototype against prototype next April.

If Lockheed's team loses, the company will likely jettison its money-losing plane-building operation and concentrate on missiles and space, which contribute half of Lockheed's $10 billion in sales and practically all its profits. A smaller Lockheed might be open to a merger—perhaps with a company such as teammate General Dynamics, which has a strong balance sheet and wants to stay in the defense game. CEO Pace says General Dynamics is sizing up prospects but won't make any acquisition decisions until it sees which programs survive the next few years: "It is very risky to acquire now. You could win big or lose big."

If the other team in the ATF competition loses and the B-2 bomber also is killed, $5.2-billion-a-year Northrop could implode. Chairman Kent Kresa says his company has no plan for what it will do if it loses both contracts. But he speculates that it could carry on making airplane parts and electronic systems—on the scale of perhaps $3 billion a year. Potential buyers for such a company: Boeing, which wants to stay in defense as a way of hedging against the ups and downs of the commercial airliner business, and Rockwell International, a company that could use Northrop's technology to complement its own electronics business.

If nobody captures the ATF contract—if the project is killed or delayed—the winners will be McDonnell Douglas and Grumman, which make the fighter jets that the ATF is meant to replace.

ROB KRAMONTH

Pace says General Dynamics will stick to defense.

Defense contractors have been searching, largely without success, for havens free of competition. Many expanded into defense electronics, for instance, on the theory that as the Pentagon buys fewer ships, planes, and tanks, it will pay to upgrade systems on the ones it has. While a safer bet than trying to market aircraft carriers, the strategy has not paid off as well as expected. Lockheed, for example, has been frustrated by the lackluster growth of its 1986 electronics acquisition, Sanders Associates. A shakeout in defense electronics seems inevitable.

McDonnell plans to fire up to 17,000 workers.

KEITH SKELTON–MCDONNELL DOUGLAS

Contractors also have been looking overseas to make up for lost business. In July, General Dynamics won permission from the government to deliver 315 heavy tanks to Saudi Arabia beginning in 1993. That will allow America's only tank producer to keep its M-1 assembly plant in Lima, Ohio, open after its Army contract expires next year.

But the international arms trade is hardly a competitive cease-fire zone. Countries such as Britain, France, and Brazil have stepped up military sales efforts; meanwhile, countries that have long been customers, such as Pakistan, Egypt, and Taiwan, have started building weapons of their own. Total arms sales to the Third World dropped 26% last year, to $29.3 billion. Faced with what is increasingly a buyers' market, U.S. defense contractors will have to fight harder just to keep the business they've got. A harbinger: Since 1985 the U.S. share of world military aerospace sales has fallen 12 percentage points, to 61%. Says Rockwell's retired chairman, Robert Anderson: "There's a heck of an arms bazaar out there."

The best alternative may be to avoid the crowd by concentrating on niches that stand to stay strong into the next century: nonnuclear missiles; lighter tanks, planes, and artillery; "smart" munitions that can locate targets themselves; antisubmarine warfare equipment; combat-simulation software for training; and information technology. Northrop's strategy is to identify characteristics that will be common to many future weapons—such as the ability to fool radar or to navigate with extreme precision—and develop corresponding products. Says Kresa: "If you are ahead in those areas, you'll be in a business everybody wants to buy in the future."

■ **CAPITALIZING ON CASH.** Arms makers are waking up to the basics of managing in a shrinking market. Says Paul Wright, chairman of Chrysler Technologies: "In the future we will be an industry measured much more on return on equity and profitability than growth, and that's a change in attitude."

Take Grumman. The future is uncertain at best for its biggest moneymaker, the F-14D, and Grumman's income statement is weighted with annual interest charges of $120 million on nearly $1 billion in debt. Says John O'Brien, Grumman's feisty ex-CEO: "We are recognizing there is significant money to be made by managing cash."

That means taking elementary steps to cut costs. The company, which processes around 50,000 invoices per month, recently finished automating its billing system. Grumman also is offering a discount to the government if it pays bills within ten days of delivery. So far the company has been able to shed $60 million of its debt.

One step that Grumman has refused, but that financial analysts say is inevitable, is to cut back operations on Long Island, the company's highest-cost location. Lockheed, on the other hand, is selling $200 million worth of plant and office space in Burbank, California—as well as cutting 5,500 jobs, 7% of the company's work force. CEO Tellep figures this "very bold decision" will save Lockheed $50 million annually and eliminate $75 million in capital investment over the next three years. Part of the aeronautics group is moving into Lockheed's underutilized plant in Georgia—home, as luck would have it, of Senate Armed Services Committee Chairman Sam Nunn.

THE TOP TEN DEFENSE SUPPLIERS

COMPANY primary military products	1990 est. revenues from govt. sales (in billions)	Percent of total sales
McDonnell Douglas airplanes, missiles, helicopters, electronics, space	$10.2	67%
Lockheed airplanes, missiles, electronics, space	$9.0	91%
General Dynamics airplanes, submarines, tanks, missiles, space, electronics	$8.6	87%
General Electric engines, electronics	$8.2	18%
Boeing airplanes, helicopters, missiles, space	$5.6	20%
Martin Marietta missiles, electronics, space	$5.4	90%
Rockwell International electronics	$5.3	44%
General Motors (Hughes) electronics, space, missiles	$5.2	4%
United Technologies engines, helicopters	$5.2	24%
Northrop airplanes, missiles, electronics	$4.6	88%

SOURCES: PRUDENTIAL-BACHE; DEPARTMENT OF DEFENSE; COMPANY REPORTS

■ **DRAFTING DOABLE DESIGNS.** A Boeing analysis of MX missile production five years ago showed that the step from drawing board to factory was appallingly inefficient. Thousands of engineering drawings were needed for the project; the average one had to be revised 11 times after hitting the factory floor; each revision cost an average of $5,000. Now Boeing and other defense contractors are trying a new approach: doing designs right the first time.

Engineers designing a weapon used to whip up drawings and hand them off to colleagues at the factory, whose job it was to figure out how to build the new device. Often they couldn't—and the process came to a halt while blueprints went back to the designers for revisions. Lately weapons makers have adopted a practice widely used by civilian technology companies such as Hewlett-Packard and AT&T. Known as concurrent engineering, it involves getting design and manufacturing engineers simultaneously to design a product and the process to make it. Thomas Murrin, a former adviser to the Pentagon who is Deputy Secretary of Commerce, says this approach can cut in half the time it takes to make a new weapon operational.

Boeing's Ballistic Systems Division employed concurrent engineering in 1988 to develop a mobile launcher for the MX. A team of design engineers and specialists in manufacturing, materials, finance, and maintenance shared office space and worked together from the beginning. Boeing used the original MX project for comparison. The outcome: a 40% reduction in the time needed to design and build the launcher prototype, and a 10% reduction in cost.

■ **SUPPORTING SUPPLIERS.** At Texas Instruments' avionics group near Dallas, managers realized that to be competitive TI needed to bind itself more closely to its best suppliers. TI enlisted them in an ambitious quality-assurance program, training the suppliers' technicians in statistical process control and certifying them to monitor their own products. Everybody wins: Suppliers who participate capture a greater share of TI's business, while TI avoids the expense of retesting every component that comes into its factories. (It still does spot checks.)

Because suppliers rarely have an opportunity to see their products in action, TI last

year did something unique: It got permission from the Air Force to let suppliers meet with flight and ground crews who used their gear. Says Dave Current, a manager of procurement assurance at TI: "There's nothing quite like having a young man who has had to repair your product stand up and say, 'It's your problem, Mr. Components Supplier. You designed it wrong.' "

Sikorsky Aircraft, a unit of United Technologies that makes helicopters, has taken suppliers even farther afield—all the way to Turkey. Sikorsky is bidding on a contract to co-produce, with Turkey, 200 assault helicopters—business Sikorsky hopes will offset its declining U.S. sales. The bidding is intense: Sikorsky is competing against Bell Helicopter Textron from the U.S., as well as French, German, and Italian companies.

In June, Sikorsky took ten suppliers to Istanbul, where they met with senior executives of Turkish manufacturing concerns. The idea was to give the U.S. companies an opportunity to form partnerships. Says James Satterwhite, a Sikorsky vice president: "Our suppliers typically don't have the connections or knowledge about foreign countries that big U.S. companies have." The trip, organized by the Commerce Department, was the first federal trade mission for a single company and its suppliers.

JACK VAN ANTWERP

Sands and Lube of Cletronics show off a monitor for cardiac patients.

■ **PUSHING PRODUCTIVITY.** Over the past couple of decades a web of cumbersome and redundant procedures has spread like poison ivy through the factories and warehouses of Wars 'R' Us Inc. GE Aerospace, Boeing, LTV, and TRW all have employees working to weed them out. At TRW's Electronics Systems Group, which builds equipment packages for satellites, employee teams are painstakingly analyzing hundreds of processes in an effort to expose and eliminate inefficiency. Similarly, at LTV's Camden, Arkansas, rocket plant, which turns out as many as 90,000 rockets a year for the Army, workers are looking for ways to make their products cheaper, faster, and better. The incentive: money.

Two years ago the plant's managers introduced a gain-sharing program. Employees were organized in teams, given productivity goals, and told that LTV would split with them fifty-fifty any savings they achieved. LTV also gave classes for workers on how to find and solve problems. The program is a winner. During the first year, the average employee received $1,900 in bonuses. General manager Wilbur Cummings says annual costs plunged 20%—boosting profits and enabling LTV to bid for new contracts at a lower price.

■ **CONVERTING TO CIVILIAN SALES.** The trick to diversification is finding businesses that play off the strengths of the company, then letting people who know the market run the show. Warns Raytheon Chairman Thomas L. Phillips: "You can't just start with a bunch of people who have done nothing but compete in the military market for 30 years, and sprinkle holy water on them." Hughes Aircraft, which wants to increase its commercial business from 20% to 40% of total revenues, has opened an office for diversification. It is trying to launch small commercial ventures that will match its military electronic products—such as lasers, microwave tubes, and very fast semiconductors—with market needs. In July the company announced the formation of HE Microwave, a joint venture with Delco Electronics, another General Motors subsidiary, which sells auto products. The new company will market sensors for both military radars and futuristic systems to help cars avoid collisions. Hughes predicts that in five or six years sales will top $400 million.

Lockheed, which for many years owned and operated the Burbank airport, wants to build and run airports all over the world. With hundreds of cities and towns in desperate need of airport space, the company thinks this business could be a fountain of cash. Some financial analysts agree. Says Peter Aseritis of First Boston: "The airport concept could be a brilliant growth strategy, if they can get state and local governments to privatize."

The company has begun developing a terminal at Lester B. Pearson International Airport in Toronto. Lockheed is an equity partner and will operate the 1.4-million-square-foot facility, which is set to open this winter. Don Jones, head of Lockheed's Technology Services Group, compares the project to developing a shopping center, only less risky since airports are a monopoly business.

Small defense companies are generally more flexible than big ones when converting to the commercial sector. But often they lack the resources to find opportunities. In Ohio, where 176,000 people work in defense industry jobs and add more than $6 billion a year to the state economy, officials set out to remedy that problem last year. The state sponsored a series of "conversion seminars," which introduce small contractors to purchasing agents from companies such as Honda, Siemens, and General Electric.

It was through such a seminar that Cletronics, a Medena, Ohio, company with estimated annual sales of $3 million, went from making camera parts for surveillance planes to medical devices. Chief Executive David Sands bought the company last November, not expecting its Pentagon business to dry up as fast as it did. By year-end, orders dropped from $40,000 per month to practically zero. Through the conversion seminar, President Robert Lube hooked up with the not-for-profit Cleveland Clinic, landing an assignment to develop a pocket-size monitor that warns pacemaker patients of potentially lethal magnetic fields.

Cletronics has also scared up new business from General Electric and even Philips in the Netherlands. Says Lube: "Some companies are sitting back waiting for the government to call, saying, 'I've got an order for you.' That's not going to happen. Defense contractors that aren't aggressive and marketing oriented are going to find themselves on the outside looking in." As is often the case in civilian business, so it now is in defense: Hustling entrepreneurs like Sands and Lube are setting an example that major companies would do well to follow, if they want to prosper. F

Credit Suisse gold bar

Mask of Tutankhamen, Cairo

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POLAND'S GAMBLE BEGINS TO PAY OFF

The Poles have achieved remarkable results in the first stages of their rush toward a free-market economy. Now comes the difficult task of staying on course.

■ *by Shawn Tully*

FOR POLAND this may be the most dangerous summer since 1939. While their Soviet neighbors fiddle, the gutsy Poles are switching from Communism to capitalism in one stroke. But their boldness has also brought them to a moment of truth. Whether they continue on what has become an increasingly painful course, or junk the quest in favor of who knows what, will almost certainly be decided in the next few months. The outcome will have ramifications far beyond the country's borders, affecting policies not only in the rest of Eastern Europe but in the Soviet Union as well.

In the first stages of their rush toward a free-market economy, the Poles have achieved remarkable results. Since January inflation has dropped to 3.4% a month from as high as 250% a month last year. The once barren stores are well stocked with goods. On weekends Warsaw's dusty Praha quarter blossoms into a colorful street market with trucks and stands brimming with everything from beef and apples from local farms to shoes from West Germany and watches from Hong Kong. *continued*

For the first time in years, stores in Warsaw are loaded with goods. Inflation is down, but unemployment, unknown under the Communists, could reach 12%.

Warsaw rebuilt these 17th-century buildings after the war. The economy needs rework now.

There has been a harsh side too, and that's where the risk lies. In the same period, industrial production has plunged 30%. Unemployment, officially nonexistent under Communism, has reached 500,000 and could rise to two million, or 12% of the work force, by 1991. With subsidies curtailed, workers find they are spending most of their paychecks on food and rent.

To make matters worse, Poland's leadership is threatening to split apart. A battle for control of the ruling Solidarity movement has broken out between Prime Minister Tadeusz Mazowiecki and Lech Walesa, head of the Solidarity trade union. Walesa wants to run for President this year, while Mazowiecki favors holding elections in mid-1991 at the earliest. Walesa's opponents fear that he will try to curry favor with workers by advocating higher wages and looser credit.

The good news is that the economic program drafted by Finance Minister Leszek Balcerowicz with the help of Harvard economist Jeffrey Sachs remains amazingly popular. Typical is the attitude of Michal Relewicz, a design engineer and labor leader at the FSO auto plant near Warsaw. He is dismayed by the hard times but still thinks the government should stick with its program. Says he: "The reforms were needed. They've stamped out inflation and improved our company's performance. At the moment the threat of unemployment appeared, we had a 20% increase in productivity."

Those ought to be welcome words for reformers, especially coming from a union leader. Still, Relewicz doesn't think the government is doing enough to revive the economy. "We can't sell our cars," he says. "And 80% of our profits have disappeared." To keep workers on its side, the government will have to engineer a turnaround in a hurry. The only way to do that is to restructure companies and attract foreign investment.

Fortunately, Poland has a lot going for it: a home market of 38 million consumers, more than Hungary and Czechoslovakia combined, plus skilled workers who are paid an average $1,200 per year. Asks U.S. Ambassador John R. Davis Jr.: "Where else can you sell your goods at world market prices and pay Egyptian wages?"

Back home in style: Zbigniew Niemczycki emigrated to the U.S. Now he heads four joint ventures.

POLAND'S FIRST non-Communist government in 45 years came to power last fall with a strong free-market bent. Finance Minister Balcerowicz, 43, a former economics professor who has an MBA from St. John's University in Queens, New York, is known as a disciple of Milton Friedman. Moving at top speed, Balcerowicz put together a crash program aimed at Poland's bogyman, inflation. For years Communist governments had bought labor peace by raising wages faster than prices, printing huge amounts of money to pay the workers and paper over big budget deficits. By last year that policy had led to a vicious inflationary spiral that threatened Poland's economic future.

On January 1, Balcerowicz put strict limits on wage increases and allowed prices to soar by erasing subsidies for most goods. Rent on a one-bedroom apartment in Warsaw quadrupled to $65 a month, while the price of coal rose 600%. Wages at the FSO auto plant have gone up less than 15%.

The shock treatment worked with savage efficiency. Says Balcerowicz: "Too much money was chasing too few goods. The key was to cut artificially high consumption." Companies accustomed to selling everything they produced—regardless of price—began fighting for business. Customers suddenly became precious. To cut costs in order to lower prices, enterprises laid off thousands of workers.

Battling to survive, the state-owned FSO has trimmed its work force and is pressing suppliers to reduce prices 30%. It cut production of the midsize Polski and relatively upscale Polonez cars 35% to a rate of 65,000 a year. Cheaper parts, says FSO President Henryk Oleniak, could allow price reductions of as much as 20%, lifting sales back to an annual rate of 100,000 sometime in 1991.

Since large sections of state-owned heavy industry—coal mining, steel, and chemicals—appear headed for bankruptcy, Poland is counting on the rise of private business to revive the economy. Small, privately owned companies were allowed throughout Poland's Communist period and now account for about 15% of industrial output. They have been amazingly durable, considering the handicaps. Companies wholly owned by Polish entrepreneurs were limited to 50 employees and could not sell to state-owned enterprises. Joint ventures with foreign partners escaped the official limits on employees but faced other penalties—including special taxes and in many cases a ban on exporting.

AFTER ALL RESTRICTIONS were lifted last fall, 80,000 new companies sprang up and existing ones began to expand fast. Sofix, a West German–owned maker of athletic shoes, is a good example. This year President Krystian Barcz expects to double sales to around $8 million. A pioneer in the use of TV advertising, Barcz has made Sofix shoes a hit with teenagers.

He now also has enough workers to keep up with demand. Though as a foreign-owned firm Sofix was not limited in the number of workers it could have, the company could never find enough. Those it did hire—mainly ex-convicts—kept prewritten resignation notes in their pockets. If the work got too strenuous, they simply handed the foreman the note, then strolled out of the plant and into another job. "My workers used to terrorize me," says the flamboyant, silver-haired Barcz, 60.

With layoffs creating a growing pool of unemployed, Sofix no longer has to rely on ex-cons. Since January its work force has expanded 60% to 760. Says Barcz: "Because workers are afraid of losing their jobs, they do what I tell them. Now I really am the boss."

Even more striking is the new attitude of suppliers. In the past, Sofix often had to wait six months for materials, and deliveries hinged on how much cognac and cash Barcz was willing to provide on the side. Now suppliers who never stooped to visit his plant are begging for orders. He can get most of the supplies he needs in a week, which has allowed Sofix to reduce inventories by half for savings of $200,000 a year.

Competition among suppliers has driven down prices too. When the state-owned enterprise that produces the chemical pellets used to make rubber soles doubled prices in January to $2.20 a kilogram, Barcz began buying them from a French company at $1.40. Polish producers are now matching the French prices and offering to improve quality to boot. Says Barcz: "We've stopped giving presents to our suppliers. But we do buy them lunch. We're a lot richer than they are."

At the Sofix shoe factory, no more resignation notes in workers' pockets

Wages for these workers at the FSO car plant have gone up less than 15% while rents have quadrupled.

In Eastern Europe's drive for privatization, Poland is taking something of a middle course. Hungary is embarking on a sophisticated, Thatcher-style sell-off aimed at attracting foreign investment in some of the country's biggest enterprises. The Czechs, who have taken a gradual approach to reform, don't even want to sell shares directly. Instead they favor a plan to give citizens "vouchers" enabling them to buy equity in state-owned companies. The vouchers would not be tradable.

In July the Polish Parliament overwhelmingly approved a plan that would put shares in the hands of ordinary Poles. Although details are still being worked out, employees could buy as much as 20% of their compa-

REPORTER ASSOCIATES *Mieczyslaw Starkowski and Wilton Woods*

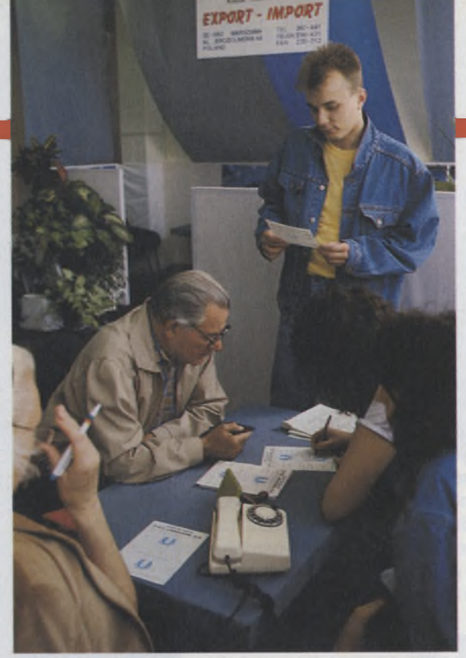
PHOTOGRAPHS BY TOMAS MUSCIONICO—CONTACT

nies, and foreign investors could buy another 10% without government approval. An additional 20% or so would be reserved for Polish citizens, probably in the form of mutual funds that would have stakes in a wide assortment of newly privatized companies. The government would keep a controlling interest initially but would list its shares on a new stock exchange as early as next year.

Once a market price was established, the government could sell the rest of its shares without being accused of selling out too cheaply—a charge that has marred privatizations from France to Mexico. Another advantage is speed. Balcerowicz hopes to privatize several hundred of Poland's state-owned companies within two years. By contrast, Hungary's elaborate process could take a decade.

Foreign investors will be able to own up to 100% of a Polish company, subject to government approval. Says Balcerowicz: "If the price is right, we have absolutely no objection to foreign control." Any new venture gets a three-year exemption from income taxes, regardless of whether it is foreign or locally owned. Starting in 1991, all foreign investors can repatriate in hard currency 15% of their earnings in Polish zlotys. Under a pending treaty the deal for U.S. companies will be even better. Over the next several years American investors will be allowed to send home a rising share of their Polish profits, culminating with 100% in 1996.

Rated on generosity to investors, Poland with its new law is behind Hungary but slightly ahead of Czechoslovakia. In Hungary foreign investors can repatriate in dollars or other hard currency 100% of the profits reaped in forints. The slow-moving Czechs are loosening currency restrictions but still offer few tax incentives. However, approval of joint ventures takes less than 60 days in Poland, compared with 90 days in Hungary.



Would-be capitalists in Warsaw sign up to buy new shares.

Investor interest is rising. Asea Brown Boveri, the Swiss-Swedish producer of heavy electrical equipment, is buying a majority stake in Zamech, Poland's largest producer of steam turbines. ABB expects to thrive on the modernization of Poland's antiquated electric power network. Italy's Fiat has signed a new licensing agreement with automaker FSM—and is negotiating another with FSO—to build a total of 280,000 cars a year in Poland by 1993. (Fiat will sell some of the cars in Italy.) Says Francesco Gallo, director of Fiat's international business: "We're cautiously optimistic. If Poland can get through the difficult days ahead, the car market will grow dramatically."

Shock treatment: Finance Minister Balcerowicz moves at top speed.

Poland is also benefiting from the expertise Polish-Americans are bringing back. Typical is Zbigniew Niemczycki, 43, an electrical engineer who migrated to the U.S. in 1977 and got a job as an electrician's helper, then rose to a top management post at Servaas Inc., the privately held Indianapolis conglomerate that turns out everything from magazines to auto parts. Returning to Poland in 1983, Niemczycki has set up four joint ventures for SerVaas that will do $100 million in sales this year.

His initial coup was exploiting the superb quality of Polish cartoon animation. SerVaas and Hollywood's Hanna-Barbera Productions are part owners of one of the largest animation studios in Europe, which does a brisk business supplying cartoons to the U.S.

Niemczycki's lifestyle matches that of most U.S. entrepreneurs. At his palatial home in suburban Warsaw, he treads marble floors and rare Oriental carpets, and unwinds in a redwood hot tub. And Niemczycki is building houses for Polish-Americans who want a retirement home in the homeland.

The big investment money won't start flowing until Poland finds a way to work down its huge foreign debts, which could cripple its economy for decades. Since the early 1980s, Poland has paid only part of the interest due foreign government lenders, and all of the interest—but no principal—to commercial banks. As a result, the debt rose from $27 billion in 1982 to $40 billion.

If forced to pay it all back, Poland would have to raise taxes and restrict imports, scaring off foreign investors. Says David Lipton, an American economist who is a consultant to the Polish government: "If the debt overhang remains, it will wreck Poland's transformation to a market economy."

TO GIVE THE COUNTRY some breathing room, Balcerowicz negotiated a suspension of payments until April 1991. Balcerowicz then proposed to settle the debt for 17 cents on the dollar, or about $8 billion. The plan's chances appear increasingly good. Especially sympathetic to Poland's plight is U.S. Treasury Secretary Nicholas Brady, a champion of debt reduction for developing countries.

As Poland speeds up and the Soviet Union equivocates, governments are questioning the wisdom of gradualism. Says U.S. Ambassador Davis: "If Poland succeeds, it will be widely imitated." For Eastern Europe, Poland's decision to move fast and stand up to the pain looks like the way to go in the 1990s. F

PRODUCTS TO WATCH

BY FREDERICK H. KATAYAMA

TED MORRISON

INTELLIGENT CAMERA

■ How's this for a *snap*shot. About the only thing Minolta's new Freedom Zoom 105i camera doesn't do is click the shutter. A programmed circuit activated by a sensor automatically adjusts for the distance between the photographer and the subject. It sets the camera's 35-mm to 105-mm zoom lens to produce what Minolta engineers consider a "pleasantly composed picture." Instead of typically amateurish too wide wide-angle or too close closeup shots, finished photos produce a balance of subject and background. Photographers unwilling to let the camera have all the fun can override the automatic feature. The camera also takes sharp pictures of moving subjects by monitoring their speed with a light-measuring cell and focusing to compensate for the time it takes to press the shutter. The Freedom Zoom 105i comes in two versions, a pearl-white one that stamps the date on the photo at $512 and traditional black for $462.

NEVER-STICK COOKWARE

■ Take a metal spatula or scouring pad to your Teflon or SilverStone nonstick pans often enough and your omelets will start to bond to the ruined surface like glue. But Farberware's never-stick Millennium cookware will stand up to the most abusive cook. Its secret lies in a new reinforced coating. Farberware blasts the pan's surface with a gritty abrasive and sprays on hot stainless steel particles to create mini peaks and valleys. It then applies two coatings of a mix of polymer binders and fluoropolymer lubricants. Result: pans so durable the company backs them with a 20-year warranty. Says Terry Troy, cookware editor at *Housewares*: "Millennium should be a hot product." On sale in October, a ten-piece set will go for $240, a 1.5-quart saucepan for $55.

JOHN DUGAN

BLOOD SCREEN TEST

■ Johnson & Johnson has achieved a big breakthrough with a new blood screening kit called the Ortho HCV Elisa Test System. It is the first diagnostic tool that detects the presence of antibodies for the recently discovered hepatitis C virus (HCV), which can cause potentially fatal liver disease. An estimated 100 million people worldwide carry HCV, which is often spread by intravenous drug use or through transfusions of infected blood. Sold to blood banks and medical labs, the kit sells for $7.50. Developed by Johnson & Johnson subsidiary Ortho Diagnostic Systems Inc., the test could reduce the incidence of hepatitis C by 75% and open up an estimated $200 million market for the company.

KEN KERR

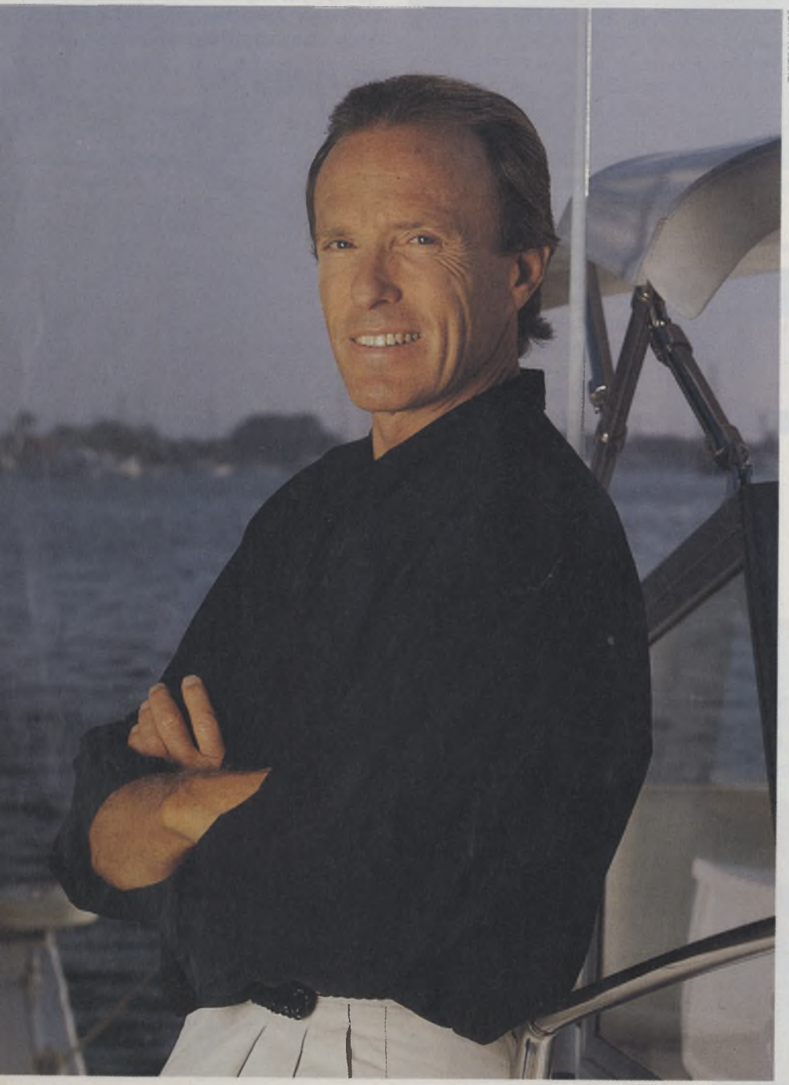
PLANE WASH

■ Washing a car by hand is a chore, but try scrubbing a jumbo jet with mop and hose. That's what airlines must do about once a month to rid the big birds of grime that causes drag in flight and cuts into fuel efficiency. Now a $13 million Automated Aircraft Washing System developed by Japan Airlines and Kawasaki Heavy Industries gives JAL's jumbos checking into Tokyo's Narita airport a robotic bath. Just five operators using the computer-controlled plane wash—equipped with 16 robotized washing units, 35 brushes, and 17 TV monitors—can have a jet gleaming in only 80 minutes at a cost of $1,300. Normal hand washing requires 20 workers and four hours, and costs more than twice as much. JAL and Kawasaki plan to market the system to other airlines, and even the Pentagon is said to be interested. Robert Keady, Japan marketing director for Pratt & Whitney whose affiliate USBI Co. is developing a competing system, calls the JAL/Kawasaki jumbo wash "an outstanding achievement." F

TOBIN BOYD

AMERICA'S RICHEST LAND BARON

Donald Bren's stunning property covers 100 square miles of California. He's worth $2 billion now, and his "build and hold" strategy promises to keep his wealth climbing. ■ *by Gary Hector*



JOHN HARDING

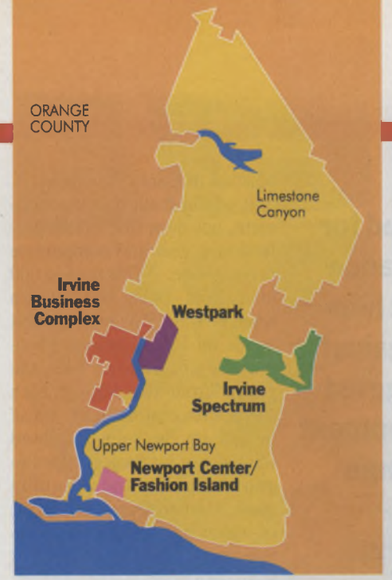
Not just a pretty face, Bren, here at ease on his boat off Newport Beach, is a driven perfectionist who calls Irvine Co.'s land his "raw canvas."

THEY TROWEL ON the glitz and hype their newest building as "the eighth wonder of the world." Their chest-thumping antics are calculated to coax lenders to pile ever more money on their illiquid little souls. Why is it that in the age of Donald Trump so few megabuilders seem able to make money *quietly*?

Here's a Donald who has. No developer is more understated—or more likely to end up rich beyond the dreams of Plutus—than a little-known Californian named Donald Bren. His Irvine Co. owns a duchy-size swath of real estate in the heart of Orange County—100 square miles of mostly raw land sitting squarely in the path of Los Angeles' southward sprawl. No one else in North America controls a single property of such vast size and potential as this.

Bren, 58, bought Irvine Co. in 1983, a transaction one admirer describes as "the best real estate deal since Peter Minuit bought Manhattan Island." He has since risen into the ranks of American billionaires. Today his 93% stake in Irvine and his other assets, which include companies that build homes and office towers throughout California, give him a princely net worth of $2 billion. But, says Carl Reichardt, CEO of Wells Fargo Bank and a member of Irvine's board, "no one but the Lord knows how much the land is really worth."

Bren intends to find out. He calls the Irvine property his "raw canvas" and plans to devote the rest of his life to its development. And what a spectacular canvas it is. Irvine Co. land begins at the Pacific, with 10,000 acres of scrub brush overlooking a breathtaking stretch of coast. To the north lies Newport Beach, one of California's toniest cities, and on the south is the exclusive enclave of Laguna Beach. The property extends inland in a rough rectangle, spilling across the coastal hills into a rich alluvial valley with thousands of acres on which the company still grows fruits and vegetables. Thence it rolls on into the rugged Santa Ana Mountains, with its easternmost border some 20 miles from the Pacific.



Bren's land, four times the size of Manhattan, covers a sixth of booming Orange County (below). His projects (map, left, and accompanying photos) blend residential and commercial development with spectacular open space.

BREN'S AMBITION is as big as the land he controls. He wants to turn his mostly empty acres into the model American community of the 21st century, filling his canvas with the familiar landmarks of late-20th-century commercial civilization—office parks, housing tracts, and shopping malls crisscrossed by highways. Loath to talk about himself, he will pop open a Budweiser aboard his 28-foot power boat as he surveys the coastline and spin grand visions of bringing the timeless beauty of Italian Renaissance architecture to his sun-parched property. Says he: "Developing this property in the best possible way is the most important thing in my life. I expect to be working on this into my 90s."

The very lushness of the Irvine holdings that makes them a builder's dream also stands as a major obstacle to their development. In real estate jargon, the Irvine land is an "in fill" project, perhaps the largest in the world. It is a hole of open territory surrounded by the established communities of Orange County. Only 125,000 people live within its borders, but some experts forecast that the number will nearly double by the end of the decade. And on Bren's domain are some of the most environmentally sensitive coastal and wetland properties in a state concerned with preserving its dwindling supply of open space and worried about overbuilding.

Development on the scale Bren envisions calls for unusual financial prowess, a deft feel for politics, and first-rate public relations skills. He follows a "build and hold" strategy—unconventional in the real estate business. Unlike most developers, whose time horizons can best be measured in nanoseconds as they scramble to extract capital from one completed project so they can finance the next, Bren works from a plan that could take 35 years to complete. He refuses to think of his holdings as a portfolio of assets to be swapped or sold and says flatly, "There is no price that is acceptable."

Bren knows that the ultimate value of his property depends on his adding aesthetically pleasing new developments that raise the worth of all that has preceded them and enrich the quality of residents' lives. This is the happiest of business imperatives, for besides making the owner wealthier it helps him win trust—and building permits—from the state agencies and local zoning boards that exert approval power over his plans.

Bren's conservative approach to financing also reinforces public confidence in his company's stability while giving it the staying power to ride out a real estate slump. His balance sheet is lean. Irvine Co. boasts a blue-chip debt-to-capital ratio of about 50%, vs. the 80% typical of other big builders.

Perhaps Bren's strongest suits are his passionate pursuit of perfection and a compelling drive to succeed. They are characteristics jarringly at odds with his quintessentially Southern California personality. Lean and tanned, he looks more like Clint Eastwood than like a corporate tycoon. He is twice divorced, with three grown children, and is portrayed as a playboy billionaire, squiring stunningly attractive women to social events and weekend ski trips to Aspen, Colorado. But beneath it all he tends to be a loner with a small circle of close friends.

His underlying personality became evident in his earliest years. Born in Los Angeles, Bren grew up in Beverly Hills surrounded by wealth and privilege, but his character was molded by the strong views of his parents and step-parents. His father, Milton, was a self-made success who helped support his family by taking a job in the mailroom at MGM studios. He became a producer in his 20s; his film credits include several Top-

The elegant marble towers of the Irvine Business Complex draw blue-chip tenants like Geneva, a merger advisory unit of Chemical Bank.

ALAN LEVENSON

REPORTER ASSOCIATES *Frederick H. Katayama and Antony J. Michels*

per films. His mother, Marion, is a patron of the performing arts. The two divorced when Donald was about 10. Milton married actress Claire Trevor. Marion wed Earle Jorgensen, another self-made man, who rose from a shipping clerk's job in San Francisco to become one of California's top industrialists and a member of Ronald Reagan's kitchen cabinet.

Surrounded by Hollywood glamour, Bren's parents wanted their children's feet firmly planted in reality. Donald and his younger brother, Peter, attended public schools. Pocket money was scarce, and the boys worked during school vacations, mainly as carpenters' helpers on buildings Milton developed in his sideline ventures as a real estate investor. Peter, who is also a developer as a senior partner in Lincoln Property Co. of New York City, remembers Donald as a perfectionist from the start. Says he: "In high school we would take old cars and turn them into street hot rods. I'd build one and it would run, but there would be a couple of screws left over. Not Donald. He would spend hours in the garage going over every detail. Everything had to be perfect. He starts at A and ends up at Z. He goes right down the alphabet."

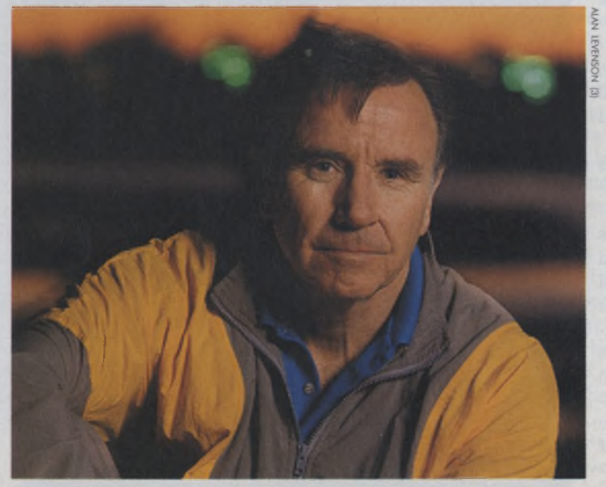
The young Bren sought out challenges that tested him against the highest standard in whatever undertaking captured his imagination. As a member of the University of Washington ski team, he is remembered by former teammates as a stylish skier and as the team's only wearer of stretch pants, which earned him the nickname "Buns." He was an avid competitor as well, placing among the top ten U.S. skiers at the National Alpine Ski Championships in the downhill and slalom combined at Squaw Valley, California, in 1956. After college—which the rich kid from Beverly Hills partly paid for himself with the help of an athletic scholarship—Bren did a three-year stint as a Marine Corps officer, training other corpsmen to survive the winter cold of the Sierras and leading reconnaissance teams in mock amphibious assaults on the beaches at Camp Pendleton.

Bren yearned for the chance to test himself against the biggest development challenge in the country.

It was in real estate development, however, that Bren's perfectionist zeal and competitive drive shone. With a $10,000 loan from Bank of America when he was 25, he built his first house on Lido Isle near Newport Beach. Plowing back the profits from the sale of each successive custom-built house he put up, he soon increased the scale of his projects. He began designing and planning whole communities, the largest of which was a 10,000-acre development in Mission Viejo just south of Irvine.

With Orange County real estate booming by the late 1960s, Bren's homebuilding firm flourished. Big companies wanting to diversify into fast-growing businesses started paying top dollar for the assets of established developers. When International Paper Co. offered Bren $34 million for his company in 1970, he grabbed it. But then recession struck and the superheated property market cooled. International Paper despaired of the business and sold the company back to Bren for just $22 million in 1972.

Having worked on the periphery of the enormous Irvine spread for his entire, still young career, Bren yearned for a chance to test himself against the biggest development challenge in the country. Known locally as the Irvine Ranch, after a Scots-Irish immigrant merchant named James Irvine who bought it in the late 19th century, the property was originally part of a colonial Spanish land grant. The remote and water-poor territory was a fine enough place to raise livestock and a few crops, but not much else. Irvine's son and heir deeded a majority stake in the ranch to a nonprofit foundation in 1937. What little building the genteel custodians did financed itself and was accomplished at a leisurely pace.



ALAN EMERSON (3)

Former Walt Disney board chairman Ray Watson is Irvine Co. vice chairman.

A TIGHTENING of the tax laws caused the Irvine Foundation to divest the property in 1977. The proposed sale piqued the interest of Mobil Corp. and other deep-pocketed companies. Lacking the money to make a run on the property himself, Bren teamed up with A. Alfred Taubman, a successful shopping-center builder from Detroit, who agreed to take about 40% in the deal. He, in turn, parceled out parts of his share to close friends—the late Henry Ford II, retailer Milton Petrie, industrialist Max Fisher, and investment banker Herbert Allen Sr. To strengthen their chances, they joined forces with Joan Irvine Smith, a great-granddaughter of the founder, and her mother, Athalie Clarke, who had inherited their own stakes in the property. The pair ended up with an 11% share.

With the equity supplied by Bren and the wealthy Easterners and a loan provided by a consortium of banks, the partners' bid of $337.4 million prevailed. Once in control, the new owners tapped Irvine's cash and refinanced some of its properties to repay all their acquisition debt within a year, well ahead of schedule. Says Wells Fargo CEO Reichardt: "That deal was an absolute slam dunk."

As great as the deal was, relations among the new owners steadily deteriorated. While Bren emerged as the largest shareholder, with 34%, the Easterners called the shots. Taubman, backed by his friends, was named chairman of the board. Bren didn't even get minor billing in the name the partners gave their venture, Taubman-Allen-Irvine Inc.

More substantive disagreements arose over development strategy. All the partners were eager to quicken the pace of building from that of the old foundation days, but how? The Taubman-led majority wanted to sell off developed parcels of commercial real estate and concentrate on putting up high-income housing. But Bren favored keeping the property whole. He was willing to sell off residential projects but thought the company should develop a mix of housing, including some that would allow moderate-income families to be able to afford to live within a short commute of their jobs.

In 1982 two events brought the simmering tension among the partners to a boil. First, a deep recession hit Southern California real estate hard and new construction lending dried up. But it was a community backlash against the company's management that caused the partnership to come unglued.

The company had leased land to some home buyers in Newport Beach and in the city of Irvine in the late 1950s, and the long-term leases were up for renewal. A decade of inflation had pushed up land prices sharply, justifying enormous rent increases. The frightened leaseholders formed a political action group, called the Committee of 4,000, to try to persuade Irvine Co. to hold down the threatened rent hikes. But when Taubman told the tenants that a deal was a deal, the committee threatened to keep "the Eastern carpetbaggers" tied up in lawsuits and to stall their plans for further development.

THE SETBACKS cost the company millions of dollars and left Bren fuming. He knew the problems wouldn't end until one pair of hands, namely his, were firmly in control. He offered his partners $518 million, which the Easterners, fed up with the tangles and eager to realize their 3-for-1 gains, accepted.

Bren's offer for 100% of the equity put a value on the whole property of about $1 billion, a figure partners Smith and Clarke considered woefully inadequate. They took Bren to court, arguing that the land was worth over $3 billion. The litigation, which dragged on for seven years, was finally settled in June when a court-appointed referee determined that the property was worth $1.4 billion at the time of the sale and awarded Smith and Clarke $149 million for their shares.

Even with the extra payment ordered by the court, the buyout was a financial coup. Against the money he borrowed to pay off Taubman and his buddies, Bren could tap Irvine Co.'s cash and accounts receivable, which totaled just over $473 million. He will pay off Smith and Clarke—an amount that may total just over $200 million, including back interest—by drawing down unused lines of credit.

Giving California mall-crawlers a taste of Old World ambiance, the colonnaded Newport Center/Fashion Island shopping arcade rings a fountained courtyard with boutiques (above). Shaded archways (left) encircle the complex.

Once in control, Bren quickly recast the company in his image. To help him, he asked Raymond Watson, then chairman of the Walt Disney board and a popular former president of Irvine Co. from the genial foundation days, to rejoin as vice chairman. The first task was to mend fences with the community by finding a way to compromise with the angry leaseholders. Bren agreed to sell them their tracts at prices that came close to prevailing market values of up to $1 million per lot. But he offered them discounts for the property improvements they had made and 15-year loans to stretch out their payments. Says Watson: "Donald's solution brought him credibility. It was fair to him, to the company, and to the people."

The deal was typical of the win-win solutions Bren continues to pursue. The company had struggled for 25 years before the California Coastal Commission and county authorities ultimately approved its plan to develop the jewel of its holdings, the oceanfront property. But when irate local environmentalists sued to block the dense development, Bren realized the project would undermine the broad community support his company needed.

Rather than fight a pitched battle with his opponents, Bren set out to disarm them with concessions that other builders, working within tighter boundaries, could not afford. He scrapped his proposed high-rise office towers. His modified plan leaves three-quarters of the 10,000 acres as permanent open space and limits building to a few resort hotels and 2,600 houses, apartments, and high-priced condominiums. Though the cost was high, he turned

local opposition into broad community support, and his showpiece development is now under way.

Bren cultivates political influence with a similarly pragmatic long-term view. An early backer of Pete Wilson, an old Marine buddy, he helped finance Wilson's first bid for the U.S. Senate in 1982. Wilson is now the Republican candidate for governor of California in the voting this fall. Bren's early support for George Bush helped the then–Vice President carry the crucial California presidential primary. Bush now consults Bren on housing, the environment, and other issues important to the state—and to Bren.

EVEN BREN'S philanthropic efforts have a utilitarian bent. His largess goes to causes that will make Irvine a better place to live—and thus a more desirable place to own real estate. For example, he sold the University of California at Irvine 500 acres of land at a cut-rate price, allowing the school to erect two million square feet of private industrial and commercial buildings. The university will use the rent it collects to recruit leading scholars in medicine and the natural sciences. Bren hopes the industry that the university attracts and the reputation it achieves as a high-technology leader will lure additional corporate R&D facilities to property he controls.

Birds feed on Irvine Co.'s Upper Newport Bay. Cactuses dot Limestone Canyon.

Bren's most sizable change was to inject management rigor into his company. In the six years since he took control, the inventory of completed leasable buildings in the Irvine portfolio has increased to nearly 13 million square feet—over three times as much as the company had built in its entire history. He added 60% in retail footage, more than doubled the number of apartments and offices, and increased industrial space nearly fivefold. Yet as the number of projects rose, Bren slashed overhead, cutting Irvine's payroll from 1,480 to 340. He requires contractors to work out detailed site plans that were formerly done in-house, but he retains absolute veto power.

It's a power he exercises freely, because top quality is his guiding principle. To give his properties the look he desires, he dispatched a team of executives on a fact-finding mission to visit Mediterranean coastal towns. They brought back photos showing the colors and styles Bren wants to emulate. He had the pictures bound and handed out as inspiration for developers to get the subtle touches right.

Bren's fingerprints are on everything down to the smallest detail. When a recent new high-rise was planned, the company erected a scaffolding in the parking lot of its Newport Beach headquarters so the chairman could see how the light played off marble slabs and glass at different times of day. Cost doesn't seem to bother him. Says Donald Koll, a wealthy competitor and friend: "He'll plant 50-foot palm trees. The rest of us buy 20-foot palms and hope they'll grow." For a technology park called Irvine Spectrum, Bren spent $250 million laying roads and constructing a freeway overpass and other infrastructure before breaking ground on a single building.

All this has created an aesthetically appealing mix and a pleasant quality of life. Clusters of graceful marble office towers sit in manicured settings. Surrounding these are residential properties adorned in stucco with clay tile. Houses range in price from $1 million mansions to $170,000 starter condos in mixed-income developments like Westpark. Shopping malls with colonnades, fountains, and shady arches like Fashion Island in Newport Beach evoke a feeling more akin to an Old World marketplace than a tacky shop-o-rama.

The system works: Of the 1.1 million square feet currently under construction, nearly 75% has been preleased. Even in the current soft commercial market, the occupancy rate of Bren's established properties is a splendid 90%, vs. just 80% for Orange County as a whole. And his office parks draw top-flight corporate tenants that include AT&T, Toshiba, and Hewlett-Packard.

Bren is pleased with what he has achieved so far. Standing at the wheel of his boat off Newport Beach, he says, "If you squint real hard, you can see the outlines of a Saint-Tropez." Today's development covers just 15% of the Irvine property, so it's hard to say whether Bren, as he fills in more of his canvas, will leave an architectural monument worthy of a Medici prince. But he's almost certain to end up as rich as one. F

ALAN BRENSON (3)

The Mediterranean architecture at Westpark sits on manicured grounds. In the project, a mix of rental and owner-occupied housing, apartments start at $825 a month; houses sell for up to $500,000.

FORTUNE PEOPLE

STEVEN PUMPHREY

Robert Paluck at play at Convex Computer's picnic. Employees voted him tops in style, form, and impact.

HIGH-TECH CEO SPLASHES DOWN

■ You can't say that Convex Computer doesn't have novel themes to enliven its annual summer picnic. Last year this manufacturer trucked 200 tons of sand to its landlocked headquarters in Richardson, Texas, and everybody gathered on the instant beach for a sand castle building contest. The sand was back this year, and the company's 1,200 employees came up with another idea: a mighty splashdown by CEO **Robert Paluck** into 72 gallons of iced raspberry Jell-O. Said he when it all was over: "I'll do something different and warmer next year."

Paluck at work

Paluck, 42, wasn't the only exec to take a dive. Five VPs followed him into the goo.

Paluck believes special events give his company a competitive edge by inspiring enthusiasm among his employees. He has used silver dollars to pay them their quarterly profit sharing—everybody gets the same amount, $216 each in the most recent quarter—and he lays on cruises for top-performing workers, though it's their co-workers who recommend the passenger list. To make sure that interoffice friction remains small, he periodically gathers all employees and puts on slide shows to demonstrate why team spirit pays off. The actors in the slides are dogs: Canines that romp together always look happy, as Convex workers should. Loners are portrayed as, well, hangdog, and represent the competitors.

Sure, it all sounds odd. But the company is doing well. Convex manufactures supercomputers costing up to $2.5 million. They are less powerful than those made by Cray Research, but Cray's cost up to ten times as much. Last year Convex earned $11.7 million on sales of $159 million, an increase of 93% and 50%, respectively, over 1988. Since the company went public in 1986, its stock price has increased from $7.50 to about $17. Customers include Ford Motor, GE, and Mobil, which will take a Convex out into the Atlantic to help scan the ocean bed for drilling sites.

PUBLISHER TAKES A PEPSI CHALLENGE

■ **Earl Graves**, publisher of *Black Enterprise* (monthly circulation: 231,400), is branching out. He's buying distribution rights for PepsiCo's Washington, D.C., operation. The new company handles 4.3 million cases of sodas a year, and the deal makes him Pepsi's largest minority franchisee.

Graves in his New York City office

ALAN DORROW

Graves, 55, will also run the company as its CEO. His partner and executive VP: **Earvin "Magic" Johnson**, 30, the L.A. Lakers' basketball hero.

The new owner isn't telling how much he paid for the distributorship, but says that Pepsi "had made a commitment in their minds to identify a black who could run the business and had deep enough pockets to do the deal." Johnson is modest about the role he'll be playing. Says he of Graves: "He's the brains, and I just smile." Johnson has been doing TV ads and other Pepsi promotions.

Graves admits he has a lot to learn about distributing Pepsi. "Right now, I know more about drinking it than I do about running it," he says, "but that will change fast."

Who'll be running *Black Enterprise* in the meantime? "I will," Graves says. Besides, he adds, "we have a lot of competent people here." Among them: oldest son **Earl Jr.**, 28, a Yale basketball star and a grad of the Harvard B-school. He's the magazine's VP for advertising and marketing.

CHEVRON'S BOSS EYES SOVIET OIL

■ Executives at Eastman Kodak, Johnson & Johnson, and a small knot of other U.S. companies interested in doing Soviet joint ventures are watching Chevron CEO **Kenneth Derr**, 54. They want him to drill for oil in the Soviets' Tengiz oil field, the biggest oil reserve discovered in a decade, which may contain more than the nine billion barrels in Alaska's Prudhoe Bay. Derr says he'll decide whether to exercise his option

By Mark M. Colodny

MARK PEARCE

Derr: weighing a "high risk" deal

to drill for the oil by December. But there are hitches. For one thing, the oil is laced with sulfur. Says Derr: "It's high technical risk, it's high political risk, and it's got to pay some money to help our shareholders." These include Pennzoil CEO **Hugh Liedtke**, who has spent $2.1 billion for 8.8% of Chevron's stock and plans to buy more.

Chevron would split the oil field profits fifty-fifty with the Soviets. The Soviets, in turn, would trade some of the hard currency they get from selling the oil for the rubles earned by members of a consortium of U.S. companies, including Kodak and J&J, thereby helping them repatriate what they make from their Soviet joint ventures.

HE TURNS ON AT AMERICAN BRANDS

■ Conglomerate American Brands has long owned nearly all but the kitchen sink. But now, says CEO **William Alley**, "you might say we own the sink too."

Almost. Alley, 60, just paid $975 million for Moen Group in Elyria, Ohio, the manufacturer of faucets. Alley is already a keen user of company products. He smokes Lucky Strikes, sports Foot-Joy golf garb on the links, and occasionally sips Jim Beam when he gets to the 19th hole. He's also tested Moen products: His home is equipped with its brass taps. Now Alley is helping to rip out perfectly good fixtures in the health club at American Brands' headquarters in Old Greenwich, Connecticut, and install Moen products in their place.

Alley bought Moen from **Theodore Forstmann** of Forstmann Little, the investment outfit that owned it. As it happens, Alley is being sued by Forstmann-Leff, a money management firm co-founded by Forstmann's older brother, **Anthony**. It claims Alley misrepresented American Brands' plans in 1988 when he bought E-II Holdings, a conglomerate in which the money managers had a big junk bond stake, and quickly resold almost all of it. F

Tyro plumber Alley installs a new product at the company health club.

MARIANNE BARCELLONA

ON THE RISE

CHARLES E. JOHNSON, 34

FRANKLIN RESOURCES INC.

■ With $44 billion in assets under this mutual fund company's wings, you might expect Johnson to sit back and let the average 0.5% fee the company charges to manage investments pay the rent. But Johnson, head of corporate development and oldest son of Chairman Charles B. Johnson, isn't content with the $253 million in revenues that the company pulled in last year from the 73 funds that Franklin runs. Johnson introduced some 25 of them. About 25% of American families invest in mutual funds, compared with around 6% in 1980, and the growth will probably slow. Says Johnson: "The next arena is the rest of the world." First stops: Taiwan and London, where Franklin is opening offices to look for more investors.

DIANE W. UPRIGHT, 43

CHRISTIES INTERNATIONAL PLC

BEN MILLER

■ In the world of art, this Upright is no slouch. She turned the Jan Krugier Gallery's by-appointment-only New York City office into a public showcase for museum-quality exhibits of 20th-century paintings and prints. As the new head of Christie's post-1945 art department in New York City, Upright must keep the gavel coming down even as the sizzling contemporary market starts to cool. "We're looking for works of very high quality that haven't reached the market yet," she says. Upright hopes that the contacts she made as a Harvard art history associate professor and as the senior curator at the Modern Art Museum of Fort Worth will turn to her whenever they are thinking about selling paintings by the likes of Jackson Pollock and Mark Rothko.

MARC R. HANNAH, 33

SILICON GRAPHICS INC.

■ "By those naive expectations we're behind schedule." So says Hannah of his 1981 prediction that sales of the computer maker he co-founded that year would top $1 billion in the year ended June 1990. Instead, despite a 59% rise from 1989, they were only $420 million. Hannah, chief scientist for the Silicon Graphics division that makes lower-end workstations in the $10,000 to $30,000 price range, continues to think on a grand scale. He is developing less expensive computers that still deliver the powerful three-dimensional graphics capability he helped design, and expects to introduce a $5,000 model within two years. Says he: "My goal is to broaden the market through lower prices." **– Richard S. Teitelbaum**

BY JOHN GRAY

THE BRAZILIANIZATION OF AMERICA

Rocketing debt, appalling schools, poor and dangerous inner cities . . . The unsettling comparison isn't so far-fetched.

■ A specter is haunting America in the Nineties: the specter of debt. A mountain of unsustainable debt threatens to transform the U.S. from a global into a regional power, to trigger large-scale and unilateral American disarmament, and to initiate an absolute decline in American living standards. Apocalyptic? Unthinkable? Yes, until recently. But now America may be on the brink of becoming the next Brazil.

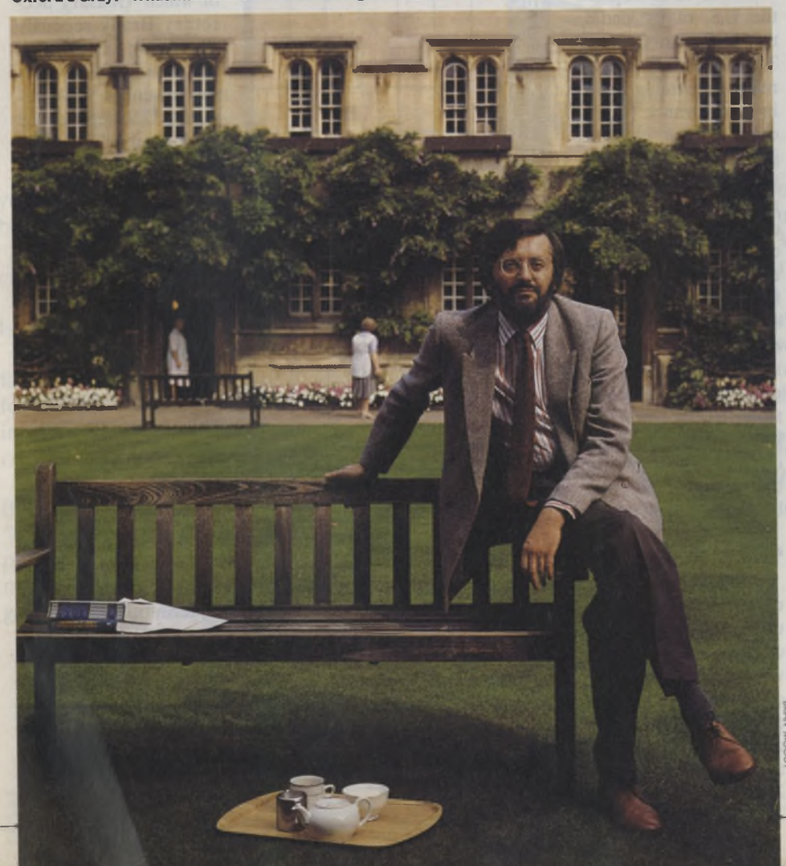
To be sure, this is a worst-case scenario—most likely. What makes it so frightening is that it could result from *current* policy. Government need not commit any egregious new blunders. Policy need only continue on its present unsteady course.

The most visible manifestation of the American debt phenomenon is the S&L crisis, which daily becomes more ominous. A recent estimate in the *Stanford Law and Policy Review* puts the cost of the bailout at more than $1.3 trillion over 40 years—an enormous number reflecting the fact that the program will be financed with 30- and 40-year bonds. But the S&L scandal may not be the most serious threat to the economy and America's standing in the world. The federal government is more deeply in debt than many people realize, with an exposure (according to a study by the Heritage Foundation) of nearly $6 trillion, including all the mortgages, student loans, pensions, and other obligations that the government guarantees.

The federal government is more deeply in debt than many people realize, with an exposure of nearly $6 trillion, including all obligations it guarantees.

In the private sector, U.S. companies on average pay around 50 cents per dollar of pretax earnings just to meet their interest bills, compared with 30 cents in 1980 and 10 cents in the Sixties. Most disturbingly, commercial banks' solvency in many regions is perhaps being undermined by falling property values. The S&L debacle may be only a prelude to a far larger crisis in American financial institutions—a sobering thought.

Oxford's Gray: "What makes the scenario so frightening is that it could result from *current* policy."



BRIAN MOODY

THE SUSTAINABILITY of American debt at present and predicted levels is made no easier by rapid shifts under way in global trade and capital flows. A rise in world interest rates, coming as a side effect of German reunification, would put highly leveraged American companies in a perilous position and increase the risk of recession. If market reform is successful in Eastern Europe, Japanese capital may be diverted there from the U.S. Already the flow of Japanese capital to the U.S. is decreasing, with Japan's Pacific Rim trade growing at least four times faster than its trade with the U.S.

Just as America's debt mushrooms, the prospect is emerging that the capitalist economies will be segmented into three principal blocs by the late Nineties: a European bloc of perhaps 500 million people, whose dominant power will be Germany; a yen-dominated bloc encompassing Australia, New Zealand, Southeast Asia, and parts of Latin America, of as yet unknown proportions; and an American bloc including Canada and possibly Mexico. Of the three, the American would probably be the smallest and least endowed with capital. The likely political response to these developments

JOHN GRAY *is a fellow of Jesus College, Oxford University. He is also Stranahan Distinguished Research Fellow at the Social Philosophy and Policy Center at Bowling Green State University in Ohio.*

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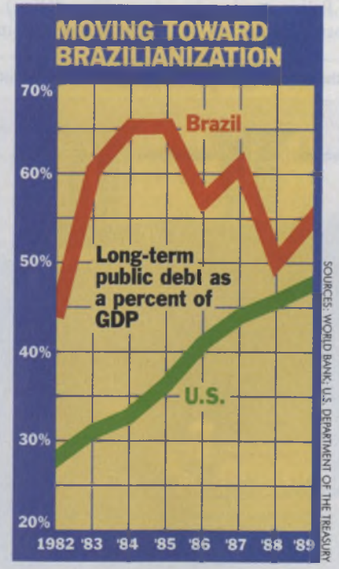
If the U.S. is to be Brazilianized, it is partly because budgetary policy rests with a Congress that is Balkanized—fragmented into warring groups.

would be a reversion to the American tradition of isolationism and protectionism. Reason: In democracies this often seems the easiest option, one that enables politicians to address the perception of a nation being unfairly victimized. The possibility of isolationism is already evidenced in the debt-driven policy of deep cuts in defense spending.

This is a scenario for Brazilianization—for relative economic decline turning into absolute decline, political as well as economic, as weakening economic performance and unsustainable debt deprive the U.S. of its leading role in the world. How? The federal deficit already constrains policy in every branch of government. For example, it inhibits effective action in an area that is rightly the serious concern of the business community: the level of educational achievement in American schools. Yes, the U.S. already spends more per student than almost any other country—with results that by any international standard are close to disastrous. But being forced to scale back is not likely to improve matters.



THE CUTTING EDGE of Brazilianization, however, is in the big American cities. The nation's huge debt has left them unable to renew themselves through needed investment in infrastructure and services. Because of high rates of intravenous drug use, HIV infection is spreading disproportionately quickly among the urban underclass. The U.S. capital is probably the least safe of any in the world, apart from cities in the grip of civil war.

This combination of unsustainable debt, declining educational standards, Third World conditions, and the breakdown of civilized life in the cities creates the prospect of Brazilianization.

Friends of the U.S. and of the democratic capitalism that America has pioneered are bound to take the worst-case scenario seriously, if only to try to contrive workable responses. The first of these must surely be a policy on the deficit. Nothing workable will be popular. Indeed, if the U.S. is to be Brazilianized, it is partly because budgetary policy rests with a Congress that is Balkanized—fragmented into warring interest groups. Among the most sensible policies: reform of deposit insurance by substantially lowering the sum insured, which would discipline savings institutions (a tepid version of which Treasury Secretary Brady recently proposed); a gasoline tax, which would raise vast revenues while reducing U.S. dependence on foreign oil; and the abolition or drastic reduction of capital gains taxes as a vital means of accelerating the growth of wealth. Taken together, these could do much to defuse the debt threat. Market competition in schooling via a voucher system—a policy thoroughly consistent with American values and traditions—also merits consideration.

What is *most* needed for the health of American society, business, and government is not, in the end, any one of these specific policies, since each is a matter of legitimate debate. It is some kind of comprehensive long-term policy made up of these or other elements, prudently and judiciously developed. That is what the U.S. most clearly lacks. If such a policy is not forthcoming, then we face the prospect of the world's greatest democracy drifting rudderless on a course of decline that may prove irreversible. F

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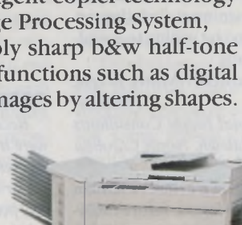

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LETTERS TO FORTUNE

OWNERS VS. MANAGERS

Re "The Big Owners Roar" (July 30): I couldn't agree more that share owners deserve to direct managers. It's their right and responsibility. But institutional investment managers are not owners; they manage owners' money. Investment managers are simply another species of corporate manager.

The best way to improve corporate performance is for managers—indeed, for all employees—to be owners and to have more than tenure at stake. Real money needs to be on the line.

THOMAS C. THEOBALD
Chairman
Continental Bank Corp.
Chicago

WOMEN AND THE 'GLASS CEILING'

In "Why Women Still Don't Hit the Top" (July 30), Jaclyn Fierman seems to have succeeded where the other widely read business magazines have failed—in getting successful women to reflect publicly about the realities of reaching the highest levels in business.

ELLEN SILLS-LEVY
Marketing Director
Connoisseur *magazine*
New York City

When my co-author and I were doing research for *The Best Companies for Women,* the unhappy truth was that even some of the best companies were the best of the worst. Women aren't making it today at the top for the same reason they weren't making it to the middle ten years ago: discrimination.

It would be nice if we could find a new reason for women's slow progress, but at bottom very little has changed in America's boardrooms. As long as companies have quasi-formal societies that exclude women, or conduct business meetings in the john, or go off on all-male golf trips, or have their dues to sex-segregated clubs paid for by the corporation, such discrimination is going to continue. Why should a male executive give a promotion to a woman when he can give it to one of the guys he hangs out with? And so he doesn't. The comfort factor continues to edge women out.

Without intervention of some sort—such as the CEO saying, "This has got to stop," and showing the rank and file how to stop it—nothing much happens. And the young men learn from their elders how to pass the sword on to one of their own kind—and not to women.

LORRAINE DUSKY
Sag Harbor, New York

You might just as well have been writing about women seeking higher elective office in the public sector. The reasons you mention for women's slow progress in reaching the top of the

ANTONIN KRATOCHVIL

"Let's accept talented, competent women for what they are and give them a fair chance."

business ladder are the exact reasons, almost word for word, that political research firms report for the snail's pace in electing women to Congress and statewide office. Namely, when women seeking higher office try to be strong, determined leaders, male colleagues are often uncomfortable and think them pushy and abrasive. Let's accept talented, competent women for what they are and give them a fair chance in corporate life *and* government.

GEORGE A. DEAN
Southport, Connecticut

Though discouraging to all women, the article spoke the truth. You are brave to bring this management dilemma in front of corporate America.

ELEANOR H. RAYNOLDS
Partner
Ward Howell International
New York City

It is not because of discrimination that women are not at the top; it is a general lack of nontechnical business skills such as assertiveness, leadership, goal setting, communication, and self-confidence. Until these basic elements are changed en masse, there will be no radical movement up the corporate ladder for women. The time will come with work and diligence that those women with the skills to lead will surface. But for this to occur, women must first stop arguing among themselves and be willing to socialize their little girls differently.

MARGARET MARY KOZIK
President
Personal Image Consultants
Raleigh, North Carolina

As if she hadn't read her own article, Fierman aimed her recommendations for the future exclusively at the parents of young girls: to teach them self-reliance, interest in sports, and flexibility. Where was the advice to the parents of young boys, the future preservers of the glass ceiling?

SUSAN SWERDLICK
Los Angeles

You identified child care and unpaid parental leave as "special treatment" women's issues. Until corporate America realizes that women are not having families alone and that today's fathers are beginning to play a larger, more equal role in caring for their children, women will continue paying the social costs, and society as a whole will lose out.

LYNN OLSON
Economic Analyst
U.S. Government
Washington

At a time when it needs the best and most creative new thinkers, the actions of corporate America deprive it of a whole class of recruits. Your article did not quote any of us who chose not to pursue corporate careers in the first place. The fact is, the market works. We make more money and achieve greater personal rewards in our own small businesses.

DEBORAH STEELMAN
Partner
Elliott Zweben & Steelman
Washington

TURNING UP TURNAROUND DOCTORS

Re "The New Turnaround Champs" (July 16): Only when we move from Wall Street and fancy financial engineering to Main Street and fixing the factory floor will the nation's industries truly have completed a turnaround.

Fortunately, turnaround doctors can be found inside almost every company. And they often need only the remedy of ownership to succeed. Many highly competent executives understand their companies' problems and opportunities but are constrained by senior management from taking the action needed. When such previously underutilized leaders are able to buy their companies or divisions, the changes they implement typically result in turnarounds.

Competent operating managers with a stake in the business are the true turnaround doctors.

E. THEODORE STOLBERG
Partner
Weiss Peck & Greer
New York City

CORRECTION

Because of a production error, two headlines were transposed in the Personal Investing chart on discount brokers in the August 13 issue. The figures under the heading "Commission on 100 shares at $30 per share" should have fallen under the column labeled "Commission on 500 shares at $20 per share," and vice versa. In addition, three phone numbers are incorrect. The number for K. Aufhauser should have read 800-645-9486; for Barry W. Murphy, 800-221-2111; and for York Securities, 800-221-3154. FORTUNE *regrets the errors.* F

Address letters to FORTUNE, Time & Life Building, Rockefeller Center, New York, N.Y. 10020. Letters may be edited for purposes of clarity or space.

KEEPING UP

Big Applesauce, the Supreme Court gets an editor, sinful moments in tax policy, and other matters.

BY DANIEL SELIGMAN

EAST SIDE, WEST SIDE

■ The latest good news–bad news story comes out of the Shiller survey, released in mid-July. For those not having heard of same, this was an opinion poll contrasting the attitudes toward capitalism of citizens in Moscow and New York City. Developed by Yale economist Robert J. Shiller and two Soviet colleagues, the survey data reflect extensive questioning of several hundred randomly selected folks in each metropolis. The good news, or at least it was basically so judged by AP and the New York *Times*, is that the Russians are attitudinally not much different on economic issues from your average Big Apple person. On the unfriendly analysis of your Gotham-based correspondent, that was the bad news.

Possibly owing to years of self-hypnosis about the wonderfulness of rent control, the median New Yorker is utterly innocent of market logic, hopelessly enthralled by the concept of "fair" prices. On many survey questions, our locals proved far more muddled than the Muscovites. Sample question: *On a holiday, when there is a great demand for flowers, their prices usually go up. Is it fair for flower sellers to raise their prices like this?* To which 63% of the Russians and 68% of the Gothamites said no.

Also lurking in the average New Yorker's cranium is a belief that speculators are apt to cause shortages (61% believe this) and raise prices (a plurality of 48% believe this). In both instances, the Russian respondents gave answers somewhat more consistent with market realities (i.e., with a view of speculators as simply equilibrating supply and demand). Possibly because of their own bitter experience, the Russians also turn out to be more familiar than the home team with the basic reason for income inequality, which is that nobody would have an incentive to work hard if everybody was paid the same amount. Incredibly, 55% of our guys said they had never heard this argument (vs. only 22% of the Russians).

Another question: *A small factory produces kitchen tables and sells them at $200 each. There is so much demand for the tables that it cannot meet it fully. The factory decides to raise the price of its tables by $20 when there was no change in the costs of producing tables. Is this fair?* This time 64% of the Russians and 70% of the Americans vote no. Alas, Shiller and friends did not ask for a vote on whether it was fair to cut prices by $20 when demand was weak.

REPORTER ASSOCIATE *Laurie Kretchmar*

FLUNKING HARRY

■ With the country now poised for hearings on a Supreme Court nominee, and for boundless recrimination over the law of abortion, we propose to indulge in a little fantasy previously not allowed out of the house. We begin by imagining that we are once again an editor of FORTUNE—the kind of editor who critiques drafts turned in by writers and assists in their enhancement. This was, in fact, what we mainly did for many years upon getting out of bed in the morning. Perhaps the major legacy of this career, not counting the undying affection of the scriveners whose copy was ennobled by our kibitzing, has been a curious inability to walk by a stretch of illogical writing without explaining what's wrong with it.

This brings us to the fantasy. It posits that our editorial chore for the day is to give a detailed response to Harry Blackmun, who for some reason (the scenario gets a bit cloudy here) has turned in a manuscript identical to *Roe* v. *Wade*—this being, of course, the famous 1973 opinion written by Blackmun and adopted (7 to 2) by the Supremes, as a result of which abortion rights got to be protected by the U.S. Constitution. We sense a need to state at about this point that we personally favor such rights; however, we very much doubt that they are constitutionally protected. Or that—as our editor's note to the Justice implies—his opinion made a whole lot of sense.

"Dear Harry: There is a lot of wonderful stuff in your draft, especially the long historical overview taking abortion from the Persian Empire to modern times. [N.B.: This is an ominous introduction, as every writer knows that editors who begin by praising particular passages are usually just groping for something affirmative to say before lowering the boom on the work as a whole.] On the other hand [N.B.: Here it comes.], the history seems mostly irrelevant to our core question, which is whether or not the district court erred in holding unconstitutional the Texas law barring virtually all abortions.

"Also logically unconnected to this question is your ensuing lengthy section on the various rationales offered over the years by those seeking to criminalize abortion in many different countries. What is that section doing there? Why do you take the reader to the 10,000-word mark, in an opinion of some 14,000 words, without having begun to marshal the argument you ultimately make: that a right to abortion resides in previous Court decisions proclaiming a right of privacy. One rather gets the sense that you felt obliged to pad the text because it might seem wrong to come up short in such a momentous decision.

"This sense is reinforced by the perfunctory character of your argument when we

ONLY IN AMERICA (Cont'd)

■ *NEW HAVEN, CONN.—A reputed gang leader whose motorcycle crashed while he was fleeing police has notified the city he may file a negligence lawsuit blaming police for the accident that nearly killed him.*

Montez Diamond, 20, suffered multiple injuries June 8 when his motorcycle crashed into the back of an ambulance . . . Diamond's attorney [has] filed a letter of intent to sue the city . . . Attorney Timothy Pothin said . . . he . . . is reviewing police reports [to] determine whether the accident was caused by police pursuit . . .

Diamond . . . has five cases pending [against him] in superior court on charges including possession of narcotics, assault, threatening, interfering with police, and reckless driving.

—From an AP dispatch.

ILLUSTRATIONS BY MICHAEL WITTE

finally do get to it. Your problem in this section is to show why a right of privacy requires a right of abortion. But you do not squarely address this problem. Nowhere do you even try to show why, under the U.S. Constitution, *a* leads to *b*. Instead, you simply asseverate: 'This right of privacy . . . is broad enough to encompass a woman's decision whether or not to terminate her pregnancy.' Harry, be reasonable. Your job is to prove it, not just say it.

"To be sure, you follow the sentence quoted with various armchair arguments favorable to abortion rights. You allude to medical and psychological risks associated with many births, to the problems of unwanted children, to the stigma of unwed motherhood. Many folks might agree that

these arguments make a right to abortion seem wise public policy. But, of course, it is not your job to set public policy. It is to decide which rights are constitutionally protected, and that's not the same thing.

"We were hoping your argument would pick up steam when you got to your three-trimester scheme, but it continued to stumble. Take the first trimester. The state of Texas justifies anti-abortion laws in this period because, it says, life begins at conception. You respond by groaning about the impossibility of deciding when life begins, since doctors, philosophers, and theologians have no consensus. Okay, fair enough. But then you suddenly turn around and *do* resolve the question. You cite various laws holding that life begins only at birth, and decide that Texas may not adopt 'one theory of life' deciding otherwise. What ever happened to all the theologians?

"Strange things occur when you set out to prove that the state may intervene only in the second and third trimesters. You begin by referring to medical data indicating that until the end of the first trimester, mortality rates in abortion are lower than those in ordinary childbirth. Let's assume that's true. You then say, 'It follows that' the state may regulate the abortion procedure from this point on. Huh? Why does that follow? Next you say it also follows from those mortality odds that the state may not regulate the first trimester. Harry, those are not even half-sequiturs. Why would any linear thinker link the state's right to regulate to the relative risks run in abortion and childbirth? What's the connection? If there was one, it would imply that the state could also regulate abortion in the first trimester anytime deaths in childbirth fell below those in abortion.

"As the foregoing remarks indicate, you have a very strong article going here. [N.B.: Editors like to conclude their critiques on an upbeat note, however mendacious.] If you would only throw out the first 10,000 words and rewrite the latter section to accommodate the above quibbles, we will surely be in business lickety-split. Sincerely . . ."

WHY EDUCATION COSTS KEEP RISING

■ *YORKSHIRE, N.Y.—The parents of a girl who broke her arm in a gym class are seeking $250,000 from the Pioneer Central School District, the school board was told . . . It was the second recent claim . . . Previously, the parents of a boy hit by a puck in a school hockey game had filed a claim for $115,000.*

The two new claims came on the heels of an $11,751 settlement . . . made on behalf of Krista Lee Schwab, who lost a tooth . . . while using the . . . elementary school slide . . .

In other business, the board voted for the first time since 1981 to raise school lunch prices. Children in kindergarten through fourth grade . . . will pay 90 cents for a Class A lunch, up 10 cents . . .

—From a news report in the Buffalo *News*.

HERE COMES ENVY

■ Among the seven deadly sins, greed (a.k.a. covetousness) still takes all the flak in media comment, even though it is increasingly overshadowed by envy. We naturally attribute this distorted reporting to media liberalism. The libs go right on getting their kicks by denouncing greed, which they see as embodied in Reaganite Republicanism. But they are tongue-tied when it comes to denouncing envy, possibly because this little sin looks to be a major theme in the latest Democratic plot to take power.

Envy must never be underrated in a democracy. As Max Scheler wrote in *Ressentiment*, a work we do not claim to have read in the original—everything we know about the chap is from citations by near-omniscient sociologist Daniel Bell of Harvard—envy comes on strongest in free societies. What brings it out is the situation in which "approximately equal rights (political and otherwise) or formal social equality . . . go hand in hand with wide factual differences in power, property, and education."

The Dems' plot is to play on envy by continuing to assert that these factual differences increased during the Reagan years because of "tax cuts for the rich." The assertions are a major theme in the "budget summit," where the negotiators act as if it is mandatory to soak the *haut monde*. This prospect is evidently conceded by the Republicans, some of whom seem to think it is sound policy. Bob Packwood of Oregon is defending the plan to scale back the deduction for state and local income taxes, arguing that 86% of the revenue raised would come from those with incomes over $200,000.

The prospect testifies to the devastating political power of envy, plainly a bigger player than rationality in Washington these days. Lawrence Lindsey's book *The Growth Experiment* demonstrates convincingly that the rich are the last folks the summiteers would be taxing in a rational world. In the Reagan years, the rich (the top 2% of the income distribution) paid a higher share of income taxes as a result of Reaganomics. They were the only group for which the extreme supply-side claim—that lower tax rates would generate more tax revenues—proved accurate. What the fiscal history of the Eighties shows is that if you are really determined to raise revenue via tax changes, you should hit the middle class with higher rates and the top bracket with lower rates. Might this actually happen? Of course not. The rich will somehow have their taxes raised, drenchingly, and when they scream, they will be charged with greed. F

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